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S. HRG. 103-611

NOMINATIONS OF ALAN S. BLINDER, STEVEN M.H. WALLMAN, AND PHILIP N. DIEHL

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED THIRD CONGRESS

SECOND SESSION

ON

NOMINATIONS OF:

ALAN S. BLINDER, OF NEW JERSEY, TO BE VICE CHAIRMAN AND MEMBER OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

STEVEN M.H. WALLMAN, OF VIRGINIA, TO BE A COMMISSIONER OF THE U.S. SECURITIES AND EXCHANGE COMMISSION

PHILIP N. DIEHL, OF TEXAS, TO BE DIRECTOR OF THE U.S. MINT

MAY 6, 1994

Printed for the use of the Committee on Banking, Housing, and Urban Affairs

U.S. GOVERNMENT PRINTING OFFICE

81-247 CC WASHINGTON : 1994

For sale by the U.S. Government Printing Office
Superintendent of Documents, Congressional Sales Office, Washington, DC 20402
ISBN 0-16-044602-3

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ALAN S. BLINDER, OF NEW JERSEY, TO BE VICE CHAIRMAN AND MEMBER OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

STEVEN M.H. WALLMAN, OF VIRGINIA, TO BE A COMMISSIONER OF THE U.S. SECURITIES AND EXCHANGE COMMISSION

PHILIP N. DIEHL, OF TEXAS, TO BE DIRECTOR OF THE U.S. MINT

FRIDAY, MAY 6, 1994

U.S. Senate,
Committee on Banking, Housing, and Urban Affairs,
Washington, DC.

The Committee met in room 538, of the Dirksen Senate Office Building at 10 a.m., Senator Donald W. Riegle, Jr. (Chairman of the Committee) presiding.

OPENING STATEMENT OF CHAIRMAN DONALD W. RIEGLE, JR.

The Chairman. The Committee will come to order.

Let me welcome all those in attendance this morning. We are a little late in starting. The Senate was in session last night until well after midnight, and so our schedule slipped a little bit this morning.

I want to welcome everyone, very particularly our three nominees that we will be dealing with. We will be starting with Mr. Alan Blinder for the position on the Federal Reserve Board of Governors.

We have, accompanying him this morning, three of our distinguished colleagues; the two Senators from New Jersey, Senators Bradley and Lautenberg, and also our good friend and my friend of longstanding and service together in the House, Congressman J.J. Pickle.

Let me just extend the courtesy of the Senate to you, Congressman Pickle, and call on you now to make your initial comments, and then I will call on my colleagues from the Senate.

OPENING STATEMENT OF REPRESENTATIVE J.J. PICKLE

Representative PICKLE. Well, Senator Riegle, I thank you for recognizing me and for extending me the privilege of going first. I am a little bit hesitant to do that, but——

The CHAIRMAN. Well, you are a senior so——

Representative PICKLE. Since you recognized me, I will accept your offer because I do have a plane to catch. I am very grateful for this chance.

I am here to add my recommendations in approving the nomination of Mr. Philip Diehl, President Clinton's nominee to be Director of the Mint. I am going to ask that my remarks be revised and extended into the record.

The CHAIRMAN. Without objection, so ordered.

Representative PICKLE. Let me just simply add that, in my judgment, Philip Diehl has amassed a very excellent record of achievement and expertise since he has been in the service. He has been Executive Deputy Director of the Mint since last September, and he has served as former Senator and now Secretary Bentsen's chief counsel.

Prior to that time, before he went to the Treasury, not only was he staff director of the Senate Finance Committee, but legislative director for Senator Bentsen. Senator Bentsen has a reputation of maintaining a high level of business achievement and philosophy. I think Philip Diehl has been a very major factor in doing that.

Philip Diehl has had both practical and business experience. He has been with the telecommunication industry in Texas. He has been vice president of the Regulatory Affairs for International Telephone Exchange, and he has been connected with the Texas Public Utility Commission.

He has had great experience here in the Senate. He helped draft the highway bill formula legislation of the 1991 Highway Bill which has helped my State and I think, Mr. Chairman did not hurt Michigan either. He knows how to put together good legislation.

Now I want to simply add, in conclusion, Philip Diehl is not only a man of achievement and recognition. He is Acting Director of the Mint now. But even more importantly, he is a constituent of mine from Austin, Texas, and a graduate of the University of Texas. So I am pleased to recommend Philip Diehl.

I know this is a big job, but in Texas, we say that is no big hill for a high stepper. And Philip Diehl is a big stepper and can do the job, so I am proud to be here and make my statement on behalf of him.

I thank you, sir.

The CHAIRMAN. Well, thank you.

He is getting good service from his Congressman today, I will tell you that.

[Laughter.]

And your word carries great weight with me and with this Committee, and we are pleased you came over to share those remarks with us. Let me permit you to leave. I know you have got a plane to catch, but we appreciate your comments and I will share them with Senator D'Amato, as well.

Representative PICKLE. Thank you very much, and you are very courteous to let me proceed like this.

Senator Bradley and Senator Lautenberg, I appreciate this courtesy but I accept it with great pleasure so thank you.

[Laughter.]

The CHAIRMAN. It is good to see you.

Senator Bradley, we are pleased to have you and we'd like your comments now.

OPENING STATEMENT OF SENATOR BILL BRADLEY

Senator BRADLEY. Thank you very much, Mr. Chairman. I consider it an honor to be able to introduce to the Committee Dr. Alan Blinder, the President's nominee for Vice Chairmanship of the Federal Reserve Board.

I've known Alan for many years and consider him to be one of our Nation's most distinguished and most highly regarded macroeconomists. Dr. Blinder will serve our Nation with great distinction, I believe, and we will all be proud that he is there.

Alan Blinder has made important contributions throughout his career in a number of different areas. For over 20 years, he served as one of our State's and Nation's finest educators. In addition to serving as the chair of the Department of Economics at Princeton, he founded one of our Nation's premiere economic think tanks.

Alan also pushed the frontiers of economic research on a broad number of issues, ranging from monetary policy to trade policy to national savings.

Most recently, Alan has served our Nation on the Council of Economic Advisers, helping President Clinton in a new era of economic pragmatism.

Finally, Alan has been a devoted father and husband. And, Mr. Chairman, if I could, I'd like to introduce his wife, Madeline, and son, William, and parents who are here today. If they could just stand and take a bow.

Thank you.

Mr. Chairman, in nominating Alan Blinder, the President described him as, quote:

> A keen intellect who reached the top of his profession without losing the common touch or ever forgetting the human implications of the often abstract economic decisions we in Government must make. He has served as an economic conscious in my Administration.

Those are very strong and moving words from a President of the United States.

But I think it's this ability to combine the theoretical with the pragmatic that has perhaps most impressed me about Alan's career. His voluminous body of work has shown him to be a clear and effective thinker about each of the leading economic issues of the day.

His writings in both the popular and academic press are renowned for their insight and, I might say, for their wit. Given the critical impact that Federal Reserve actions can have on the lives of all Americans, this sensitivity and depth will be an invaluable asset, as Alan continues his career of public service.

Mr. Chairman, I might say that I do think that this is probably the best friend I ever had to assume such a high post. So I am kind of approaching it with a little caution, because I don't want to go overboard.

At the same time, I believe it's an extraordinary appointment for an extraordinary person who will serve with distinction, who will make us all proud of his values and his mind, and who I think will truly be effective on the Federal Reserve Board, so I am sure this Committee will grant him speedy and unanimous confirmation as the next Vice Chairman of the Federal Reserve Board.

The CHAIRMAN. Thank you very much, Senator Bradley.

Senator Lautenberg, we'd like to hear from you now.

OPENING STATEMENT OF SENATOR FRANK R. LAUTENBERG

Senator LAUTENBERG. Thank you very much, Mr. Chairman.

It's a pleasure for me to sit here with Bill Bradley who has known Dr. Blinder for some time. I hadn't but I know quite a bit about him, and as a matter of fact, we were chatting in the anteroom. I was talking to this pleasant fellow and I walked out here and I asked where Dr. Blinder was, and they said, well, you were just talking to him. And I said, well, I thought he was a much older man. He'd written so much and he'd said so much, and so much attention's paid to him that I didn't think it could be in a body as young as we saw back there.

But it's a pleasure for me to introduce and to recommend Dr. Blinder and to congratulate his family. His sharp intellect and his professional skills will add a strong and steady voice to the Board's work.

Mr. Chairman and Members of the Committee, there is no better testimony than that which comes from Mr. David Mullins, the most recent Vice Chairman, who Dr. Blinder's going to replace, has stated that the appointment of someone of Dr. Blinder's stature, ability, and intellectual integrity will strengthen the Federal Reserve. And we are delighted to hear that said.

Until his most recent position on the President's Council of Economic Advisers, Dr. Blinder had a distinguished career at Princeton University which dates back to 1971.

In addition to chairing the Economic Department, he was named the Gordon S. Rentschler Memorial Professor of Economics at Princeton, and founded Princeton's Center for Economic Policy Studies. I won't list all of the boards and panels on which Dr. Blinder has served, nor all of the books and articles he's written because, though they're impressive, we'd be here all morning if we attempted to do that.

Mr. Chairman, this is a particularly significant appointment because our Nation has been through some very difficult economic times. And in the recent recession, New Jersey lost over 260,000 jobs, many of which were high wage, high technology jobs that will be hard to replace. And the Federal Reserve Board plays a critical role in guiding our Nation's economy. Its' decisions, while complex and removed from the rough and tumble of the political arena, significantly affect the lives and the livelihoods of all of our constituents. So we need wise and understanding hands on the wheel of the Board. Hands that understand the complexities of our economy and the hopes and the fears and the concerns of our people.

Dr. Blinder has all of the requisite skills to do this difficult job, and beyond that, he's demonstrated a clear, dedication to the public interest and a boundless appetite for making correct, tough deci-

sions. We are lucky to have his services in Government, and obviously I hope that the Committee and the Senate will be able to move quickly to confirm his appointment.

Thank you very much, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Lautenberg.

Let me say that we appreciate both of you coming. I want you to feel free to excuse yourselves and attend anything else you need to, and you're also welcome to stay if time permits that.

Let me now sort of set the stage for what will happen here this morning. We will be considering three Presidential nominees, two of whom now have been introduced, first by Chairman Pickle from the House side, and now our Senate colleagues.

Let me just say, for the record, that in addition to Alan Blinder who is here with respect to the Federal Reserve position as Vice Chairman, we will be hearing later and questioning Stephen Wallman for the Securities and Exchange Commission and then, of course, Philip Diehl for the Directorship of the Mint.

We will be starting this morning with Mr. Blinder. It's certainly fair to say that the Vice Chairmanship of the Federal Reserve Board is an extremely important position in our Government and it's one that powerfully affects the daily life of literally everybody in the country.

The Federal Reserve has a critical role in national economic policy and in financial regulation, and I think we are seeing literally at the present time the impact that Fed policy decisions can have on the economy and on expectations and economic behavior.

It has the prime responsibility for minimizing economic fluctuations and maintaining low rates of price inflation. In addition to that, I think it has a critical role to see to it that our economy operates as closely as it can to full employment so the job opportunities are out there, not just for Federal Reserve Board members and people who are well-situated in our society, but for everybody across the country.

It is a very important public charge to be there and to have to carry so much important policy responsibility as it relates to what actually happens to people out across the countryside.

The Fed is also the principal financial regulator for a large share of our State-chartered banks, and it supervises and partly operates our payment system. These powers give the Fed a key role in avoiding systemic financial market failures, another essential task that they have.

I would underscore what has earlier been said. This nominee's qualifications for this job are superb. The Committee favorably reported the nomination of Alan Blinder just 10 months ago for his current position as a Member of the President's Council of Economic Advisers. And on that team he has proven to be a key member and that experience adds now to his already impressive background. Serving as he has, as a professor of economics at Princeton for more than 20 years, being the author of numerous articles for professional journals, receiving a number of academic honors, and as the author of one of the most widely used economics principles textbooks, he brings with him a wealth of relevant experience.

I am not sure that anybody's experience, however, that fully prepares one to assume a position on the Fed as Vice Chairman or as

Chairman because of the enormity of the implications of the policy decisions that have to be made, and the fact that things keep changing.

Alan Greenspan has said, many times before this Committee, that trying to make sense out of the monetary aggregates and how people handle their money and how instruments change and how money moves around makes it very difficult to use yardsticks that might have been appropriate or seemed appropriate even 3 or 4 years ago, in terms of judging the velocity of money through the system and the way money changes forms and how it in turn impacts the real economy on a daily basis.

At the present time, the Fed faces a number of very demanding and difficult issues. Of primary and central importance is finding the interest rate policy which can best sustain the current economic expansion. And there's a lot of concern about that at the present time.

I heard some last night from one of the major business developers here in the Washington area with a superb record who expressed to me very directly his real apprehension that, if interest rates keep going up, we are going to see this recovery aborted.

That's one person's opinion, but it's more and more typical of the kind of opinions that I am hearing from people who are out there trying to make the economy grow.

We know the Fed recently has moved short-term rates up 75 basis points, but mortgage rates have thus far risen twice that amount. And that certainly ought to have, and is I think beginning to have, a significant effect on the economy. If it's the Fed's intention to tighten, certainly that has had a tightening effect, perhaps what they sought or perhaps more than what they sought. But I do think we are approaching the point where further increases in interest rates can run a real risk of a halt to growth here, and the last thing we need to do is to go back into another recession.

I think the interest rate policy of recent years has to do more than just repair balance sheets, as important as that is to do, and as much as that's been accomplished. There are a lot of economic entities in the country that need to not only get on a solid footing, but also stay there, stay there and not be put into a situation where we start sliding backward again.

Also the Fed has a number of important and noteworthy regulatory issues to resolve, along with the other bank regulators. These include a need for significant consolidation of our bank regulatory agencies, and how to ensure that public risks posed by the private use of derivatives are limited and kept within a boundary that ensures that we do not run systemic risks that we would only find out about too late, risks that we couldn't properly manage if we were not very alert and ahead of the curve.

We also need far better enforcement and application of our community reinvestment and fair lending laws on the part of the Fed. Of all of the banking regulatory agencies, the one that seems to have the hardest time really getting with it with respect to stopping the abuses in fair credit practice and fair lending has been the Fed. And while some progress has been made, more is needed, and I certainly would look forward to this nominee to do something about it.

I know the citizens in the country who are minority people, unlike most of us in this room, are still struggling to get the kind of fair shake out of our financial system that the law says that they should get, and so our regulatory authorities have a lot to do with making sure that the laws are applied fairly, and we've got some progress to have to make in that area.

I very much look forward to hearing your views and will question you about these issues.

Let me now yield to Senator D'Amato.

OPENING STATEMENT OF SENATOR ALFONSE M. D'AMATO

Senator D'AMATO. Thank you very much, Mr. Chairman.

Mr. Chairman, I have an amendment that I am going to be offering on the floor in a few minutes, so I will not be able to stay for the full hearing.

I am going to ask that my statement be included in the record as if read in its entirety in order to save some time.

The CHAIRMAN. Without objection.

Senator D'AMATO. I will note that I had a meeting with Alan Blinder. I am convinced that he certainly has the intellectual capacity, the experience, and the integrity to do the job in a manner that will be exemplary.

I think we all feel very strongly about the independence of the Federal Reserve. I recognize that Professor Blinder has served in key positions including being a Member of the President's Council of Economic Advisers. I believe Professor Blinder has the intelligence and capacity of keeping the Federal Reserve independent. That independence is something that many people, including myself, believe is critical.

Now one of the problems that Professor Blinder finds himself in is that he has written extensively. Judge Bork found that to be a problem, too, you know. We pick all of these statements and we use them whenever. We sometimes forget the original context in which they were made. Then some years later, they come up at a confirmation hearing and they're thrown at you.

Senator SARBANES. Could the Senator yield on that point?

Senator D'AMATO. Certainly.

Senator SARBANES. As Senator Bradley pointed out, he's written with wit, which is even more dangerous.

[Laughter.]

Senator D'AMATO. And sometimes, you know, these things come back to haunt you. Unfortunately, you're probably better off if it's "see no evil, hear no evil, say no evil." Then you go sailing through.

Nobody can just say, "Well, that's a good question, we will have to think about that. At this point in time, it would be inappropriate for me to take a position for that matter." We've all seen those types of nominees come through. It doesn't matter which Administration. That's the best, and then you win.

I hope I don't ruin your reputation because I don't know whether or not they've read this. However, let me quote from something that you've written entitled "Hard Heads, Soft Hearts." Maybe we shouldn't let Senator Sarbanes hear this.

[Laughter.]

You say:

Mandatory price controls substitute the political judgment of the State for the personal judgment of the market, thereby interfering with the signalling role of prices and impairing economic efficiency. In the early stages of a controls program, the costs are small and almost invisible, but the distortions mount and become concrete as a system of controls ages and ossifies.

I have to tell you, I have never, in two short paragraphs, heard something more eloquently, and more cogently put. I am convinced, given your intellectual capacity, the fact that you understand balancing the various needs. We have talked about the important role of the Fed, recognizing the signals as it relates to inflation, and how one would attempt to move in a way that would give due recognition to all of the considerations. The President has put forth someone most qualified to serve in this very important capacity.

Mr. Chairman, I intend to support Professor Blinder. I said to him before, how can I be of help, should I say something good about you or say something bad.

[Laughter.]

We will just let it fall out there. I am delighted to see your beautiful, magnificent family with you.

The CHAIRMAN. Thank you, Senator D'Amato.

Senator Sarbanes, who I want to call on next, serves, as you know, as the Vice Chairman of the Joint Economic Committee and has done a distinguished job there, and will be, in all likelihood, the next Chairman of this Committee. And that is a positive thing to anticipate.

Senator Sarbanes also served as the Administrative Assistant to Walter Heller when he was the Chairman of the Council of Economic Advisers for the President and has a been a very serious student of economic policy matters, and particularly Fed policy actions.

And so I want to call on Senator Sarbanes at this time.

OPENING STATEMENT OF SENATOR PAUL S. SARBANES

Senator SARBANES. Well, thank you very much, Mr. Chairman. As you said in your opening statement, this is a very important hearing, and the position of Vice Chairman of the Federal Reserve is obviously a very substantial position in our policymaking spectrum.

I frankly think that every position on the Federal Reserve Board is a very important position, and I regret that I think in recent times there has been a tendency to focus only on the Chairman and the Vice Chairman and not on all seven members of the Board, since they in effect are equal in terms of their votes and in terms of making policy.

And I will not get into the role of the regional bank presidents who serve on the Open Market Committee but are never nominated or confirmed by any public officials. They simply get there on the basis of being picked by private interests, but that is another and a separate issue.

I am going to say just a few words about Alan Blinder in a moment, but I want to set the stage for what I may pursue later.

This is this week's Business Week. The cover story is "Why Are We So Afraid Of Growth?" Conventional wisdom holds that the U.S. economy cannot sustain rapid growth without inflation. But that may be wrong. The reason, a wave of innovation is boosting

productivity while global competition is keeping prices down. And it then goes on, on the inside, in the continuation of this story to say, why strong economic growth will not cause inflation. It then says, productivity is surging, workers are more skilled, capital investment is more efficient, international trade is expanding, the information revolution is gaining speed. The result, low inflation.

The U.S. economy's expanded at a 2.4 percent annual rate since 1980. Most forecasters figure that the economy's growth potential is 2.5 percent at best. But the evidence is mounting that it could be as high as 3.5 percent without touching off inflation. Here is why.

Now that is another 1 percent. If this is in fact accurate, that is another 1 percent on the growth rate, which is tens of billions of dollars of additional output, hundreds of thousands of additional jobs without an inflation problem, according to this analysis.

And coincidentally, there is an article in today's op ed page of the New York Times by Lester Thoreaux entitled "The Fed Goes Ghostbusting." And talks about their pursuing ghosts on the inflation front and the impact that it is having on growth.

So I just wanted to make that by way of a preliminary in terms of our economy and how it may function, what the possibilities may be at this particular time in which we find ourselves. In fact, the Business Week says, far from being a mature economy, the United States is one in the throes of an historic transformation. And of course, if that is the case, we need to adjust our thinking to accommodate it; otherwise, we may be squandering some wonderful opportunities. And I think we need to keep that very much in mind.

The CHAIRMAN. Would you yield at that point, just for one moment?

Senator SARBANES. Certainly.

The CHAIRMAN. First, I would like to make a unanimous consent request that we include both of those items, the op ed piece today from the New York Times and the Business Week article in the record.

But also to say that across the country, there are still millions of people who cannot find work, and I am talking about people at all skill levels. People with Ph.D's, people with training in computer technology and so forth, as well as people lower down on the skill ladder. And many people have lost their jobs as big companies have downsized, and so they are out there trying to get reestablished.

Many times, there is a big backward slide. They may lose a job that pays $35,000 a year and after 6 months or a year, find a job that may pay $22,000 a year.

So I think the issue of getting all the growth we can out of the economy, without an inflation problem, is essential to those people in the country who are, in many cases, desperate for work. Want to work, need to work, need to be producing for themselves and their families and for the country.

The country undergoes an enormous loss of gain if we are not more fully employing our people and our resources because we have got some artificial notion that we cannot have as much growth as perhaps we really can have if we are really thinking about those kinds of issues.

I will tell you this. With respect to the problems of our inner cities, where there is so much social tension and difficulty and deprivation and hardship, if we do not get more economic activity infused in those areas, that we are going to continue to pay a huge price.

So there are a lot of reasons to want to get the growth rate as high as we can possibly take it in a responsible fashion, and I think this is a real issue at this time.

I thank the Senator for yielding.

Senator SARBANES. Now, Mr. Chairman, I am pleased, along with other Members of the Committee, to welcome Alan Blinder here this morning. I strongly welcome the President's nomination of him to go on the Federal Reserve Board and to serve as the Vice Chairman.

I have known Alan Blinder for many years, largely because of our common association with Princeton University. I was fortunate, as a young high school student, to get a scholarship which made it possible for me to attend Princeton, and my children were all there as undergraduates.

Professor Blinder earned his undergraduate degree at Princeton and his Ph.D from MIT. He became a professor at Princeton at a very young age. In fact, since 1982, has held a very distinguished endowed chair there, the Rentschler Memorial Professor of Economics.

He was chairman of the Economics Department in the late 1980's, was the founder of Princeton's Center for Economic Policy Studies. He's a prolific author, ten books on economics including a textbook which has come to be in standard use in introductory courses in economics, so that there are young men and women all across the country who are being led into economics [notice I said into and not away from] by Alan Blinder's textbook.

He's written many scholarly articles on macroeconomic policy. He's served as vice president of the American Economics Association, a mark of recognition from his peers. He served briefly as the Deputy Assistant Director of the Congressional Budget Office in 1975, and as you noted, for the last 10 months, has served as a Member of the President's Council of Economic Advisers.

I think it's fair to say that he's generally regarded as one of the leading economists of his generation. He brings to Government service analytical skills of the highest order and, in my view, a welcome, real world pragmatism unhindered by ideological preconceptions, something that I think is very, very important.

I don't think he comes to this job or that he has reflected in any of his past work any sort of rigid thinking. I mean, he's prepared to look at the facts and make his judgments accordingly.

Unlike, if I may for the moment, introduce a light note into these proceedings in terms of rigid thinking, the man who came home at 3 o'clock in the morning, and his wife said to him, "where have you been?"

And he says, "I have been out riding my bicycle." She says, "you haven't been out riding your bicycle. I took your bicycle into the shop this afternoon in order to get it repaired." And the fellow says, "that's my story and I am sticking to it."

[Laughter.]

Now he's never reflected that kind of hidebound thinking, and I certainly welcome that. We need someone who's a realist and a pragmatist to take over these responsibilities at the Federal Reserve Board.

He also brings a keen sensitivity, and you made reference to this I think, to the impact economic policy has on the everyday lives of people. I think he understands that. I think it's very important that that be understood by policymakers in whatever position they find themselves, whether in the Executive Branch or the Legislative Branch or the Judicial Branch. I mean, they need to have some understanding of how these decisions impact the ordinary lives of people.

We held a hearing earlier this week with the homebuilders and the Small Business Council who came in to tell how they were being impacted by the rising interest rates, and how it meant less jobs and so forth and so on.

I think, in conclusion, this is an outstanding appointment to the Board, and I believe Alan Blinder will serve with great distinction. I notice that his nomination has met with widespread acclaim and I share in that.

Thank you very much.

The CHAIRMAN. Thank you, Senator Sarbanes.

Senator Dodd I think was called out for a telephone call, and I want to let him make his statement before we start with you, so let's just wait 1 minute here.

[Pause.]

OPENING STATEMENT OF SENATOR CHRISTOPHER J. DODD

Senator DODD. Mr. Chairman, I would ask unanimous consent to be able to submit a statement for the record.

The CHAIRMAN. Without objection, it's so ordered.

Senator DODD. I welcome our witness here this morning. We are very honored to have someone of your background and quality nominated by the President, and I look forward to statements and some questions.

The CHAIRMAN. Very good.

Thank you, Senator Dodd.

Let me ask you to stand now and raise your right hand as I administer the oath.

[Witness sworn.]

The CHAIRMAN. I know Senator Bradley acknowledged members of your family, but please feel free to make any personal comments or introductions you want to make, and then we'd like your statement now.

Mr. BLINDER. Thank you, Senator.

I would like to introduce my wife, Madeline.

The CHAIRMAN. Madeline, nice to see you.

Mr. BLINDER. My son, William.

The CHAIRMAN. William.

Mr. BLINDER. I have another son, Scott, who's in Chicago right now and couldn't be with us.

My mother, Shirley Blinder, from Florida, and from Bayonne, California.

The CHAIRMAN. Welcome.

Mr. BLINDER. And my wife's parents, Shirley and Leon Schwartz, from New York.

The CHAIRMAN. It's nice to have all of you.

Mr. BLINDER. It looks like we have geographical diversity, as on the Board.

[Laughter.]

STATEMENT OF ALAN S. BLINDER, OF NEW JERSEY, TO BE VICE CHAIRMAN AND MEMBER OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. BLINDER. Mr. Chairman and Members of the Committee, this is the second time, as you have noted, in less than a year that I have appeared here as a nominee, and I want to thank you again, as I did then, for the speed with which this Committee is handling my nomination. I know you have a crowded agenda and I appreciate the prompt attention.

There is, as you have noted, very important work to be done at the Fed, and I am quite eager, with the Senate's approval, to get down to doing that.

I'd like to just begin by saying that I am deeply honored that the President has nominated me to be Vice Chairman of the Board of Governors. Having spent much of my adult life watching monetary policy from a distance and studying its effects on the economy, I am keenly aware of how difficult the Fed's job is and how very important.

Millions of Americans who haven't the slightest idea of what goes on at the Fed are nonetheless affected by its decisions, so I approach this assignment with a mixture of humility and awe, and with the utmost seriousness.

Because I was before this Committee so recently, and because I have had such very nice introductions, for which I thank all of you, I think I will just skip the little biographical information in the statement, except to issue a semi-apology at the beginning.

I think I am quite familiar by now with current, prospective, and indeed past monetary policy issues because I have been studying these for many, many years. I am rushing to educate myself on the many legal and regulatory issues now facing the Fed. I have learned a lot in the last 10 days. But I have got a lot more to learn.

It's given me, by the way, an appreciation for the weight and thickness of the agenda in front of this Committee, and if I can't answer any of your questions on this, I will apologize in advance.

I think I can answer many of them by now, and I will certainly try to answer all of them, and not just say, "that's a very good question." I will try to, to the extent I can, do better than that.

As I mentioned a moment ago, monetary policy is an arcane art understood by few but affecting many. Along with fiscal policy, it's one of the two tools the government has for influencing the pace of macroeconomic activity. And indeed, in today's environment, with the macroeconomic aspects of fiscal policy all but locked in for 5 years, monetary policy must bear almost the entire burden.

Monetary management was never an easy job and nowadays, with the financial markets more complex and more global than they ever were before, it is harder than ever. To complicate that, as Chairman Greenspan has noted a number of times, the tradi-

tional monetary aggregates, the so-called "M's," are currently of relatively little use as guideposts to monetary policymakers.

So the Fed really has no choice but to watch everything and make its best judgments about when the economy needs to be spurred on and when it needs to be reined in to guard against inflation.

Nowadays, changes in the Federal Funds rate are the normal vehicle for putting such decisions into effect.

That very brief characterization of monetary policy seems to encapsulate the way the Fed has been conducting its business lately. And it's a framework, I must say, with which I feel quite comfortable.

At this juncture in history, no one on the FOMC can afford to be dogmatic, nor to swear allegiance to any particular indicator.

But the techniques of monetary policy are far less important than the goals. What should the Fed's objectives be?

To me, this is a very, very easy question, for Congress has prescribed them for the Fed in the Federal Reserve Act, as amended, and I just want to quote the words exactly. It says:

> To promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates.

And I just want to say a few words about each, and especially about stable prices.

The phrase "maximum employment" cannot be taken literally. In principle, every person in America could be working, but that's hardly desirable. A large, dynamic economy like ours will always have millions of people who are, in a literal sense, between jobs. They may be looking to improve their prospects; they may have recently lost their jobs and are looking for new ones; they may have skills which don't match very well the available jobs and therefore need retraining, and a variety of other things.

So economists say that, at any point in time, the economy has a so-called natural rate of unemployment which, to a first approximation, and this is the important point, cannot be changed by monetary or fiscal policy. I interpret the goal of maximum employment to mean limiting unemployment to this natural rate.

Mr. Chairman, you said it exactly right when you used the phrase, "all the growth we can without igniting an inflation problem." That's exactly what I take maximum employment to mean.

To a significant extent, the second of the three things in the Federal Reserve Act, moderate long-term interest rates, follows directly from stable prices; and I am coming to that in just a moment.

I only wanted to mention, however, that interest rates, long-term or short-term, have a real component as well. The plain fact is that while monetary policy has a profound effect on long-term inflationary expectations, its influence on real long-term interest rates is indirect and muted.

Many other factors, such as the balance of private saving and investment, and importantly, the prospects for the Federal budget, have larger effects on long-term real interest rates. And in this respect, I have been very proud to be associated with the Clinton Administration's efforts to bring down the Federal budget deficit along with the Congress.

Let me now come to "stable prices," the phrased used in the Federal Reserve Act.

This translates directly into low inflation. Some would even say zero inflation, but that's a more illusive concept than it seems at first. Different measures of inflation give you different readings.

For example, over the last year, the core CPI inflation—by core, I mean excluding food and energy—has increased 2.9 percent. The core producer price index has increased just 0.4 percent. And the GDP deflator has increased just 1.9 percent.

Those are three different numbers, three measures of inflation, but they all share one thing in common. Each of them is at or very near the lowest readings recorded in a generation.

This country has indeed made great strides in reducing inflation and this achievement should neither be forgotten nor belittled.

A second set of complications in defining what we mean by stable prices stems from measurement problems that make conventional price indexes overstate inflation. Among these are difficulties in accounting for quality improvements and for the introduction of new products, and also consumers' quite intelligent tendencies to shift their spending toward products and toward sales outlets where prices are rising less rapidly than average, and away from those where they're rising more rapidly than average.

For all of these reasons, analysts believe that the consumer price index, for example, may overstate inflation by something between half a percentage point a year and 1.5 percentage points a year.

So just as zero measured unemployment would be an inappropriate translation of the phrase "maximum employment," zero measured inflation would be an inappropriate translation of the phrase "stable prices."

Chairman Greenspan has said that his working definition of stable prices is when inflationary expectations do not play a role in household and business decisions. I have often, in conversation, used a similar definition that zero inflation is when ordinary people stop talking about inflation. By either of these definitions, to me, the United States now looks to be close to, but not quite at, stable prices.

Since I have been accused of being "soft on inflation," I'd like to take a few minutes, if you will allow me, to clarify my views on that very important subject.

First, it is clear that lower inflation is always better than higher inflation, at least until we reach zero true inflation, whatever measured inflation that might correspond to.

In a book of mine, which has been cited as evidence that I am a friend of inflation, and from which Senator D'Amato just kindly quoted, I wrote the following:

> Inflation does indeed bring losses of efficiency. It also makes people feel insecure and unhappy. We would no doubt be better off without it.

Now, somehow, some people have read that and said that that's evidence that I am a friend of inflation. I am not quite sure how you get that from statements like that. But let me say that, to me, the only real questions are: how low should we try to push inflation and how fast? At what point is the benefit of further inflation reduction worth the incremental cost of achieving it?

And that brings me to my second point, which is that there is no magic bullet for fighting inflation. The painful truth is that reducing inflation is costly. This country paid a very high price, a deep and long recession, to bring inflation down from about 10 percent to about 4 percent in the early 1980's. But that price was necessary because double-digit inflation was intolerable.

Then, after we overshot normal capacity and inflation crept back up above 5 percent in 1989 and 1990, we suffered through another, though smaller, recession to bring it back down to the current level of something below 3 percent.

These costs, as you Members of the Committee have stated, are not abstract costs. It means that millions of people lost their jobs by enlisting in the battle against inflation, some of them for long periods of time. And we shouldn't forget that. Having paid that price to achieve these gains on the inflation front, it would, in my estimation, now be sheer folly to squander them. There is simply no good reason to push the economy beyond its normal capacity and into the inflationary zone.

Any job gains we enjoyed in the short run would be balanced by job losses later.

If unemployment is to be pushed down below what is currently estimated as the natural rate, and I think we should try to do that, it must be done by structural policies, like education and training and things like that, not by monetary policy.

Third, short run fluctuations in inflation depend on more than just monetary policy. Fiscal policy, through its affects on aggregate demand, can be either inflationary or disinflationary. Food and energy prices, which are largely, though not entirely, beyond our control, may push inflation up or down for a while. Sometimes we are lucky and inflation declines, as in 1985–86 and again last year. Sometimes we are unlucky, as when OPEC struck in 1973–74, and in 1979–80, when inflation shot up.

If monetary policy is used effectively to cut our inflation losses when luck runs against us and pocket the gains when good fortune runs our way, then we can continue to chip away at the inflation rate, which is already low, and make sure it continues down.

Fourth, and finally—this is my last point on inflation—there really is wisdom in the old adage that where you stand depends on where you sit. The Federal Reserve is society's ultimate bulwark against inflation. That's a stark fact that I think gives every member of the Board a special responsibility that I, for example, never had as an outsider.

It is the reason I think that Congress wisely gave the Fed so much political independence. Congress' intent was, pretty clearly, to ensure that the Fed would be able to take the long view and do what is best for the economy, passing up opportunities for short run gains if they came at the expense of the economy's long run interests.

If you take that long view, there really are no conflicts among the three goals that Congress gave the Fed: maximum employment, stable prices, and moderate long-term interest rates.

Mr. Chairman, given what I have just said, it won't surprise you to learn that I am strongly supportive of the independence of the Fed. And the main reason for that is simple: I think an independ-

ent central bank is best for the long run economic welfare of the country. But independence need not and should not mean arrogance, insensitivity, or lack of accountability. The Fed should not be watching election returns or public opinion polls, but it should be watching the economic well-being of the average American. And it should always remember that it has 260 million clients.

The American people do not want inflation, and they do want jobs. That's what Congress has asked the Fed to deliver, and that's what it should try to do. Yes, the Fed is judged everyday by the financial markets, but these are fleeting evaluations. Its ultimate judges are the public and history. In fact, I believe that the ultimate long run verdicts of the markets, of the public, and of history will all be the same.

Independence of the central bank also need not and should not mean mystery. The minutiae of central banking will always be mysterious to most people, nor do they much care. But the Fed's basic decisions about monetary policy affect almost everyone. And while the process of reaching them is best conducted in private, so that frank interchange is encouraged, the decisions themselves should be transparent.

In this regard, I heartily applaud the Fed's recent practice of announcing FOMC decisions explicitly and promptly, rather than leave markets guessing while professional Fed watchers divine its intentions. It is a step I have long advocated, and I hope it will be made a permanent part of the Fed's operating procedures.

Indeed, I think the Fed can do a better job than it has to date of explaining its goals and policies to the American people, and I would welcome the opportunity to assist in getting that done.

Mr. Chairman and Members of the Committee, I thank you for listening. I hope this statement has conveyed to you my basic views on monetary policy, and I'd now be happy to answer any questions you may have.

The CHAIRMAN. Thank you very much, and of course, we will make your full statement a part of the record.

As you have watched the recent upward adjustments in monetary policy rates by the Fed, have you been surprised as to what the market reaction has been? I mean, as a scholar and as a student of these issues, you must have had an expectation as these policy moves were put in place as to what the effect would be. But as you watched them play out, have they sort of played out as you imagined, or are we seeing things that perhaps are outside of what you might have thought would be the case?

Mr. BLINDER. On the effects of the Fed's actions on long-term interest rates, I was certainly surprised. I think most observers of financial markets were surprised.

The historic norm is for long-term interest rates to move in the same direction as short-term interest rates, but by a smaller magnitude. Sometimes, in fact, they go the other way. Occasionally, long-term interest rates fall when short-term interest rates rise. There are historical cases in which that has happened. But the historical norm is certainly for them to rise, but by much less than the increase in short-term interest rates.

What we have seen in this recent episode, since early February, is about 75 basis points on short-term interest rates, on the Fed-

eral funds rate, let's say, but 110 basis points or so on long-term interest rates, the 10-year or 30-year bond rate, and as you noted a few minutes ago, even more than that on home mortgage rates.

It's not historically unprecedented for certain, but it's historically unusual and, yes, there was some surprise in that.

The CHAIRMAN. What do you make of that? Having seen that now sort of come in differently than we might have expected it would, what's your interpretation of that?

Mr. BLINDER. There are a number of possible factors that could have driven the market interest rates up to the extent that they did.

One hypothesis, and I think it's a leading hypothesis, is that while this was all going on—starting in fact before this was going on, before the Fed started moving but continuing through the Fed's move and even continuing to today—there have been increasing perceptions in financial markets, in America and all over the world, about the strength of the U.S. economy, how fast it's likely to grow in the short and intermediate run.

Now I think some of these perceptions may have been exaggerated in fact. Many people got too excited at the 7 percent growth rate in the fourth quarter, which was never going to be sustained.

It is nonetheless a fact, I think, that most private sector forecasters marked up their forecasts between, say, last December and now, or between January and April. So there was a feeling that the U.S. economy was doing better than people thought a few months ago. When something like that happens, it can trip off two kinds of beliefs that affect long-term interest rates.

One has to do with the real demand for credit. If you think the economy is going to grow faster than you thought a few months ago, that means you believe the demands for credit will be growing faster than you thought a few months ago.

So the real component of the long-term interest rate, to which I made reference a few minutes ago, will rise. And I think a great deal of this recent run up in interest rate had to do with that.

Now you could ask very well, was this warranted? Maybe it was, maybe it wasn't. But I think it had a great deal to do with the rise.

The second kind of belief that economic strength trips off in people's minds is about inflation. The critical——

Senator DODD. If I could just interrupt you, you have answered our question. Was it warranted. I mean what's your opinion of that?

Mr. BLINDER. I believe it was warranted as to direction and most likely the magnitudes were exaggerated. Now that's a hard question to answer because different people have different beliefs, so when I say the magnitudes were exaggerated, there are no doubt many people who didn't have exaggerated views.

But I can tell you that as we saw these data coming in at the Council of Economic Advisers, we did not find them terribly surprising, given our basic outlook for where the economy was going in the short run. A little bit on the optimistic side, but only a little bit.

Now, as I was saying, the other kind of belief this can trip off in people's mind is greater worries about inflation.

First, of all, I think, as a short run matter, those who harbor such fears have exaggerated fears.

Second, I don't think the main issue is in the short run. I don't think in fact that many market participants harbor inflation fears for the very short run. So let me say a little bit about each.

The indicators we have, the current readings on inflation and the best indications we have of what's on the short-term horizon, do not indicate any acceleration of inflation.

The issue really is what is coming up on the horizon a year or two later. And here the question that Senator Sarbanes raised in his opening statement is critical. How fast is the economy growing relative to the speed at which capacity is growing? How quickly are we closing the gap between actual GDP and capacity GDP? And by capacity, I don't mean the limit of what the economy could produce—we are nowhere near that, but the normal operating rates of companies above which inflationary pressures begin to mount.

There's a wide range of opinion on that issue right now. My own view is, to some extent, agnostic but not completely. I think some people are voicing very strong views on this issue, which I would be inclined to reject. But that nonetheless leaves a reasonable range for people to disagree over, for example, how long could the economy grow at, say, 3 percent before reaching capacity.

Some people might say only about a year. Some people might say 2 years. I suppose there are people who would say more than that. I wonder about that. But I think there's reasonable room for disagreement in that kind of a range.

And so there are people, I think, who may have extrapolated recent high growth rates too far into the future, and have visions of the economy shooting through its capacity into the inflationary zone not 3 months from now, not 6 months from now, but a year from now, or 15 months from now, or a year and a half from now.

The CHAIRMAN. I want you to be complete, but I don't want to have all my time used on just this one matter, because I want to go to a next phase of that question.

So let me give you a minute just to finish that, and then I want——

Mr. BLINDER. I can stop there, if you like.

The CHAIRMAN. All right. Let me tell you the concern I have at this point.

I've talked with many families out there that are trying to buy a house—maybe they've waited a long time to sort of get their financial footing, and have the economy show some additional strength and so forth, and have a little more job security—who've been waiting to buy a house or maybe to trade up because they're in too small a house and their family has grown. All of a sudden the interest rates have gone up. Long rates have gone up an abnormally large amount from these more modest, short-term Fed policy rate adjustments. To them, that's inflationary. I mean, as they look at it, that's an element of inflation to them, especially if it's an unwarranted premium that's coming into those long ranges.

I think inflation is sort of in the eye of the beholder. I mean, there's a lot of different ways to decide what is or what isn't inflation, but to somebody who is thinking they might finance at 7 per-

cent and is now looking at 8.5 percent, that's a price inflation in the interest rate that may in fact prevent them from financing right now.

Senator SARBANES. Mr. Chairman, would you yield on that point? I want to visually demonstrate the point you're making.

These are the mortgage interest rates, 30-year conventional percent. The week of February 4, it was just under 7 percent.

The CHAIRMAN. That's our joint birthday.

Senator SARBANES. That's right.

The CHAIRMAN. Coincidentally.

Senator SARBANES. And the week of April 22, 8.49 percent. Now that's exactly the point you were just making. This is what these people have come up against, and of course——

Senator DODD. My birthday's on May 27.

[Laughter.]

Senator SARBANES. You're going to be off the chart. You better get your mortgage now.

Senator DODD. I did.

Senator SARBANES. This jump from 7 to 8.5 percent, if you have $100,000 mortgage, is a jump from $660 to $770 a month in your monthly payment.

The CHAIRMAN. Well, I make the point not to be dogmatic the other way, but I sometimes am concerned that there are people that may be, Fed policymakers that don't understand that high interest rates can also be inflationary. I mean, it can be, all this sort of cross-connects.

What I am really interested in is where we go from here, and whether we would likely see further upward adjustments in Fed rates maybe again having an unintended and perverse effect, but instead of bringing down long rates or raising long rates a lesser amount than the short-term rates go up, that lo and behold, you get this double whammy. You have a smaller short-term rate increase and you get an amplification in the long rates, and then all of a sudden, you're running into all kinds of problems with home equity loans, car loans, house loans, other things. And I don't think we need that at this point, and I am wondering where do you think we are here? In other words, if another adjustment were to jack up long rates, is that a wise policy prescription now?

Mr. BLINDER. Senator, just as I said, I found it quite surprising that long rates jumped up as much as they did in response to what was, after all, a quite modest rise in short rates, especially at the beginning. It was only 25 basis points at the beginning.

Just as I said that, I would certainly not anticipate, looking forward, that if the Fed were to raise short-term interest rates again, that we would have the kind of magnified reaction.

This is, as I said, not the historic norm by any stretch. That's sort of why I ran on so long explaining what I thought might be happening in the current context.

The answer to the implicit second part of your question is: Should there be such a magnified reaction of long rates to short rates again, I think there's very little doubt that that would have a slowing effect on the economy. It's not what I would anticipate in terms of——

The CHAIRMAN. Of course, it's what you didn't anticipate the last time either, so——

Mr. BLINDER. I was about to say, markets are full of surprises. I didn't anticipate the last one, and nobody could sit here confidently and say, no, it will not happen again. Nobody can say that.

The CHAIRMAN. I want to do just one, quick follow-up and I won't trespass on the time of others here at length. But what I don't want to see right now, and I would hope that you would not want to see, is I don't want to see the economy start so sputter and that we start to slide back into a quasi-recession.

We were in a recession of sorts for a long period of time, and in fact the time that it took to work our way back up to the same employment level was much longer than has been true in other recessions in the post-war period.

And no one's quite sure, even though our prospects look good, you know, how vulnerable we might be to getting into a situation where we start to lose steam and go back into a situation that I don't think any thoughtful person wants to see happen.

I guess I would want to hear from you today, a view to the effect that it is important to stay on a solid growth path here into the future, and not go off into recession. I am concerned that there's some people that might think because there's been a needed and a valuable repairing of balance sheets that that somehow means the all clear signal is out there.

I don't sense that. I find that there are an awful lot of businesses today, particularly small and medium-sized businesses, as well as a lot of big businesses, that are going through difficult transitions, and I think they need to have vibrancy in the economy for a period of time here to continue to adjust and to work off past problems and to get through some of these transition issues. Would that be your view?

Mr. BLINDER. Yes. I do not think that what this country needs now is another recession. I most certainly do not think that.

The job of the Federal Reserve now, as I see it, is to assist the economy. I don't want to exaggerate the extent to which the Federal Reserve controls the economy, because it does not.

The CHAIRMAN. I don't mean to imply that either.

Mr. BLINDER. But to assist the economy into gliding back to capacity. We are getting closer.

A year and a half or 2 years ago, we were so far away from capacity that it was almost an irrelevant consideration. It is not irrelevant now. We are getting much closer to capacity, but I don't believe we are there yet. So I think it is of the utmost importance to let the economy, and help the economy, back to capacity without overshooting.

Now there is no perfection in this business. And there is no doubt that there will be errors in one direction or another. I think it's critical now that members of the Federal Reserve Board, balance the risks, and I certainly would. The risks are not only one-sided. The risks are not only of going too far and having inflation, nor are they only of going too slowly and having continued slack. They are both. They are quite balanced now in a way that they weren't balanced a year or two ago. They were quite unbalanced then, and the clear need was to grow faster.

Now they're becoming quite balanced. But I don't think we should go overboard to the other extent and be, as the Business Week headline suggested, "Afraid of Growth." Growth is good for this society as long as, exactly as you said, it doesn't pass the point where it starts tripping off inflation.

The CHAIRMAN. Senator Sarbanes.

Senator SARBANES. Thank you very much, Mr. Chairman.

I must say, I think that was a very reasoned discussion of some very important economic issues, and it's the kind of discussion that I think we need to encourage, not only in policymaking centers but all across the country.

I was struck when you said in your statement that the Fed ought to sort of explain it's decisions. I forget exactly how you put that. Explaining its goals and policies.

More broadly than that, I think there's a real need to try to analyze the economic situation. You know, we need to ask the kinds of questions that are being asked in this article. Are we unreasonably afraid of growth or changes taking place that in effect would enable us to have a different analysis for the economy.

Let me just underscore one point. You said in your statement, analysts believe that the CPI, for example, may overstate inflation by between ½ and 1½ percent per annum. Now you're not out there by yourself on that.

Let me read you this exchange I had with Chairman Greenspan. I said to him:

> Now I also understand that the Bureau of Labor Statistics has done some studies published in the Monthly Labor Review, which suggest that the inflation figure of 2.7 percent, which was what the figure was for last year, it's now even lower on a year to year basis, could actually overstate the actual inflation rate by as much as ½ a percentage point. Are you familiar with those studies?
>
> Chairman Greenspan replied that he was and that, in fact, their view is that they suspect that the adjustment may be even more than that.

Then I asked:

> And is that based on some studies which the Fed staff has done?
>
> Chairman Greenspan answered yes. He explained that the Fed staff and a number of economists in the private sector have been looking at these data in some detail.

Then I said:

> Well, now, if those studies are accurate, and I will not, because time is limited, probe into the factors of those studies, although, Mr. Chairman, at some point it might be helpful for us to do a hearing that would do that, but if those studies are on track, then it is quite possible that we are really dealing with an inflation rate more around 2 percent than 2.7 percent. Would that be correct?
>
> Chairman Greenspan replied yes, that is a CPI inflation rate.

The point I was making earlier with Chairman Ovey is that if one looks at the broader inflation rate, it is probably less than that, even less than 2 percent.

So as we consider this inflation question, if in fact the current measurements are overstating it, we need for people to understand and to comprehend that.

Now Chairman Riegle made reference to the potential inflationary impact of the rise in interest rates itself. I just came from a hearing with the Bureau of Labor Statistics where they reported the monthly unemployment figure, which has dropped a tenth of a point to 6.4 percent, with some good job growth last month.

But we pursued this impact of higher interest rates on the CPI. Now, as it turns out, the only direct measurement in the CPI of the impact of interest rates is the cost of financing the purchases of automobiles.

And according to the BLS, a 20 percent increase in interest rates on auto loans from say 8 percent to 9.6 percent, would raise the inflation rate by a tenth of a point.

There are other ways of course higher interest rates would raise the inflation rate. They raise business costs, they raise home ownership costs.

Now we are measuring home ownership in a different way. We impute the rental value. But if we did it the old way, of course an increase of the sort that I showed on that chart represents a 17 percent increase in the monthly carrying charge for that mortgage.

Now if that applied to all housing costs, you'd get almost a 5 percent increase in the CPI. Obviously it doesn't apply to all housing costs, but if applied at 10 percent only of the housing costs, you'd get a ½ a point increase in the CPI.

The CHAIRMAN. And might I just say that would include home equity loans as apart from new originations of mortgages because a lot of those are cranking up right now, so you have got that built-in effect. The rise in interest rates automatically starts to get passed through to a lot of home equity loan holders and people with ARM's.

Senator SARBANES. That's right. I was going to add that. The adjustable rate mortgages as well.

So we have always regarded this interest rate question as slowing the economy, impacting on the speed and movement of the economy, but it also, in and of itself, it seems to me, has an inflationary component to it. I wonder if you have any observations on that particular issue?

Mr. BLINDER. Yes, I will be glad to Senator, especially if you'll stop me short if I start devolving into techno-babble. I will try to not do that.

Senator SARBANES. The other thing, as Chairman Riegle noted, I know you're used to speaking in 50-minute clips when you give a lecture.

[Laughter.]

We need to ask some additional questions here, so I'd add that point.

Mr. BLINDER. But I get a lot of ideas out in those 50 minutes.

[Laughter.]

I will be much shorter than that.

When interest costs of businesses rise from one level to another level, the business will experience a one-time increase in cost. That will presumably translate into a one-time increase in prices, probably with a lag. It doesn't happen in an instant.

In order for interest rates, through the mechanisms you were speaking of, to actually be an engine pushing up inflation, that is the change of prices, the interest rates would have to be racing upward, upward, upward, upward, rather than just going up once and leveling off.

The second part of the answer is that there is a substantial amount of evidence in econometric models, and here's where I

apologize especially for the techno-babble, that when you look at the direct—what I would call the cost push—effects of interest rates, which is what you were just referring to, and the effects of higher interest rates or tightening of monetary policy on inflation indirectly through aggregate demand and the balance of supply and demand in the economy, I think the evidence is pretty overwhelming that on balance a tightening of monetary policy or an increase in interest rates would be a restraining influence on inflation, notwithstanding the cost push impact that you just mentioned.

Senator SARBANES. Now of course, I would regard this movement in the mortgage interest rates as racing upward and upward. It may not go on, but certainly that movement from where this arrow is right here, which is 3 months ago only, to where it is now would meet my definition of racing upward and upward.

Mr. BLINDER. Well, absolutely. What I meant by that is continuing to race upward. We certainly don't expect it to be moving upward at that kind of a clip for very long.

Senator SARBANES. I want to throw out a thought I had, and I'd be interested in your views.

I am increasingly concerned by the extent to which there seem to be these overreactions to the latest monthly figures. Now all these fellows are sitting over here at the table, waiting for you to say something that would warrant them bolting from the room and racing to the telephone and putting in the call, and then the market will move one way or another.

But increasingly now, we are getting this volatility playing off of—you know, the latest CPI figure, the latest unemployment rate. We get some good job reports, so you get good news, and then you get a bad news reaction to it, so to speak. And there's all this churning of the markets that seems to be going on all the time, without reference to more basic medium- or longer-term trends. In fact, the long-term trends are all very good.

I mean the core inflation rate in 1990 was 5.2 percent. In 1991, it was 4.4 percent. In 1992, 3.3 percent. In 1993, 3.2 percent, and for the 12 months just ended in March, it was 2.9 percent.

The producer price index is even better than that, much better. I don't know what can be done about it, but I think this constant instantaneous reaction to yet the latest little bit of economic news, which isn't factored into a more comprehensive look or more of a pattern, it just moves around a little bit, I am increasingly concerned about it.

But you get this tremendous volatility, you get all this churning in the markets. I take it some probably make significant moneys out of playing off of that volatility and that churning, and therefore it's advantageous to them. But I don't see any benefit that accrues to the long-term or even medium-term economic objectives of the society.

Mr. BLINDER. The participants in financial markets, as you know, Senator, are constantly searching for news of some sort. A long-term trend, such as what you just cited, is of course much more important to the long run well being of the society of the economy or anything. But long-term trends like that, almost by definition, are not news. They don't change in a day. They certainly don't change in 15 minutes.

In financial markets, there is a premium on being there first and reacting in the correct direction to the latest news.

Now you say a lot of money is made on that and, yes, a lot of money is also lost on that. There is usually someone on the other side. If someone is making money, someone is losing money. So market participants are constantly searching around for scraps of news and, as you suggested, I will try not to add any scraps in answering your question.

You will remember, Senator, that it was not that long ago that people used to dote on the Fed's announcement of the weekly money supply figures—the weekly. That used to be the big news that hit the market every week. And markets reacted very strongly to weekly measurements, most of which most of us thought were mainly measurement errors at a weekly frequency. But markets moved on them anyway. They do not move on them anymore. The weekly money figures hit. The Fed is still announcing them—or rather monthly, I should say. They are not really big news any longer.

The markets are now responding to a variety of other things, including some of the things that you mentioned.

It is worth mentioning, however, that despite impressions to the contrary—and these impressions always come back when you have walked through or lived through a period of short-run high volatility as we have—there really is not any evidence of a great increase in volatility, say, in the 1990's compared to the 1980's or the 1970's in most of these financial markets.

These markets have been volatile at short frequencies for a very long time. They still are volatile. They will probably be volatile for as long as any of us are alive.

The last thing I would say about it is just to come back to your point about policy makers, what really matters for policy decisions is not the hour-to-hour or day-to-day movements in markets, but exactly those long-run trends to which you were calling attention.

Senator SARBANES. Mr. Chairman, I know my time is up. I just want to make one final point; it goes back to the necessity to try to develop a deeper level of understanding about——

Let me give you this example: When we got the GDP figures most recently, the GDP figures and the GDP deflator went up from 2.3 percent to 2.9 percent. That then triggered a reaction in the bond market. The growth figure was down to 2.6 percent from 7 percent.

So that in effect should have been a reassurance that you were not having a ranging kind of economy here moving to be out of control. But everyone looked in there and they said, ah, but the GDP deflator went from 2.3 percent to 2.9 percent.

The GDP deflator includes exports, whose prices went up—largely food because of the floods, but those are goods that are being sent abroad whose price has gone up—but it does not include imports, which of course as we have mentioned is a restraining factor on the rise of prices in this country.

In fact, Chairman Greenspan in testimony said that the better thing to look at is the deflator in final sales to domestic purchasers which would include imports. Now if they had looked at that deflator, it would move from 2.3 percent to 2.4 percent.

So what happened is the markets reacted off of a measurement which I would suggest was completely inappropriate because the increase in that measurement was from the rise in export prices, and that measurement failed to take into account import prices which are restraining the rise in this country of domestic prices.

If you took the import prices into account, you really had no movement at all: 2.3 percent to 2.4 percent.

The CHAIRMAN. Thank you.

Senator Dodd.

Senator DODD. Thank you very much, Mr. Chairman.

You are covering an awful lot of the ground on the inflation issue. I just want to join my colleagues here, the Chairman and Senator Sarbanes, in emphasizing the concern.

It is a national concern, obviously, but I do not need to tell you, given your own familiarity with the New England States and I am not going to focus on New England. Obviously your decision-making process does not deal in limited geography.

Nonetheless, the legitimate point is being made I think about the fragility of the national recovery that is exponentially true when you start talking about New England, and particularly a State like Connecticut where even the modest recovery that is occurring is not something we can relate to. We are still feeling it very, very strongly.

Obviously my constituents feel very strongly about the interest rate hikes and what that has meant to even some possible improvements in the local economy.

I am concerned, coming back now to the national perspective on this, there is a very good article this morning—I do not know if the Chairman or others have mentioned it—by Lester Thoreaux.

Senator SARBANES. We put it in the record.

Senator DODD. Oh, it is in the record already.

You do not have to agree with everything there, but looking at some of the global statistics, I think they are important in terms of wages and what has happened and what is happening around the globe.

So again the prospect of a looming inflationary cycle seems unwarranted. But the erratic behavior of the Fed, aside from the negative implications that it is creating in terms of the currency markets, is a matter of immediate concern.

I wonder if you might address what your thoughts are regarding the dollar and currency markets and whether or not you are concerned about the short- and long-term implications for the economy with what steps have had to be taken in the last few days.

Mr. BLINDER. I will, Senator, although there is a limited amount, as I am sure you can understand, that I can say about that.

If you will excuse me, could you just clarify a little bit what you meant when you said "the erratic behavior of the Fed"? I was not quite sure.

Senator DODD. Well, in a sense, the anticipation of moving up, coming back just does not seem to be well thought out here and explained well—I think the point that Senator Sarbanes has made, and I think you made.

I have a great deal of respect for Alan Greenspan and people at the Fed, but there does not seem to be a linkage here that is being

drawn very clearly. Just the mere anticipation. I mean, the news this morning in anticipation of the May 17 meetings in light of the reports on job creation here at home is having its own impact.

It seems to me an appropriate statement being made by the Fed at this particular juncture might do an awful lot to cause markets to react differently and people to react differently. So maybe the word "erratic" is a little tough, but I will still use it.

Mr. BLINDER. The way I heard it—and please correct me if I am wrong—is that the question is directed at the notion that the Fed's recent actions, or maybe prospective actions, have created certain uncertainties?

Senator DODD. Absolutely.

Mr. BLINDER. OK. I think you have a point.

Whether the short- and medium-run strategy of the Federal Open Market Committee is in fact well thought out I do not know, because I have not been on the committee yet. I hope it is well thought out and, with the approval of the Senate, I will be there soon and I will know. I do agree, however, that it has not really been well articulated.

As a result of that, Members of Congress, people in the public, people in the markets, are not quite sure. You can never be quite sure and, indeed, even if you are on the Federal Open Market Committee you have got to keep your eyes open and be nimble and prepared to change. So there is no such thing as "certainty."

Senator DODD. I agree.

Mr. BLINDER. But I think, as I was suggesting in my opening statement and I think you were suggesting it strongly, that the Fed could have done a better job than it has of articulating what it sees as its basic mission—not in the very, very long term; we all know what its basic mission is in the very long term—but over some shorter horizon and how this all coheres.

I agree with that.

Senator DODD. Let me just add, for instance on the first hike frankly I was supportive. I think you could make a case that the less-than-neutral rates, and so forth, need to be corrected.

I think the reaction of the market that day of a 100-point drop, had we waited longer, it might have been 400 or 500, and what a reaction that would have created.

So I do not want to be in a position that I have disagreed with every step here.

I am less than enthusiastic about the second.

I find the third very troubling in the direction we seem to be going.

So let me make it clear here that I am not going to take a position of every time the Fed reacts with regard to interest rates is wrong; quite the contrary. In fact, I would find myself being supportive of the first hike.

I am sorry. I did not mean to interrupt you.

Mr. BLINDER. You did not interrupt at all. I was just agreeing with you. I took the sense of your suggestion to be that the Fed could do a better job of articulating what it was up to, and I agree with that. I agree with that very much.

Senator DODD. We have covered the inflation point pretty well. I want to raise two other questions with you.

One is in the derivative activities. There is a lot of discussion about this of banks and other financial firms. There are some concerns particularly being raised by some Members of Congress about the potential impact of the markets to a systemic risk associated with the use of some of these new exotic products.

Let me take advantage of the forum here to say that I find derivatives, and in fact exotic products, to be exciting and encouraging. I do not have the reaction that some do that, because it is new we ought to be fearful of it.

That has to be balanced, obviously, with some 25-year-old going out and being unchecked by more responsive elements in where they take us, but I would be very interested in how you respond to this issue and whether or not you think there is a need here for a heavy regulatory involvement.

Mr. BLINDER. In some sense there is a need—and there already is. The bank regulators are watching this activity quite closely.

I would not go so far as to say they have achieved perfection in this. I do not think the regulators believe they have achieved perfection.

This is a new phenomenon. A lot of banks are involved in it. Only a very small number of banks are involved in it in a very serious way, those committing large amounts of money to these kinds of trading activities.

To me there are two concerns that overwhelm all the others.

The first is that none of these activities ever impair the safety and the soundness of the banking system. That is primary. That is my opinion as a citizen. When I go on the Federal Reserve Board it will be my opinion even more strongly, because that is one of the responsibilities of the Board.

Second is the concern that you raised about systemic risk. People are quite excited now about some of the very large market movements and the role of derivatives in perhaps promoting that. You hear very large numbers bandied about about the size of this market.

Senator DODD. Right.

Mr. BLINDER. I do not think we know nearly enough about that to make good judgments.

I think the regulators need to be watching this because it is new, and it is evolving. This is not a constant phenomenon. If you spoke about the derivatives market 3 months ago, and the derivative markets 3 months from now, they are going to look different. So this is indeed a serious challenge to how nimble regulators can be.

The Federal Reserve, I know, is collecting a tremendous amount of information on this activity right now.

One thing that needs to be improved, that I do know about already, is better assessments of market risk as opposed to credit risks. I think the Fed has a fairly good handle, although not a perfect one, on credit risk aspects and therefore how much capital, by conventional definitions, needs to support activities like that.

FDICIA, as you know, directed the authorities to work on interest-rate risk. I think that was absolutely appropriate. It was something that I as a private economist had long thought should be done.

It is not easy, but it needs to be done. The derivatives are a particular challenge in that regard because a lot of these are unconventional instruments. But it is a challenge that is not impossible.

I know the Board staff, and I presume the other bank regulators, are working on this now. There is just a lot more work to be done. But that is a direction in which we must move, I think.

Senator DODD. Well, I would hope—and I know the Chairman has a strong interest in this subject matter, and we have got a lot on our plate here in the next few weeks—I would hope we might be able to work very closely with you on this.

There is going to be a lot of activity on the House side on this issue pretty quickly. It seems to me it is in our interest to be involved, to the extent we can be, in obviously the work the Fed is doing. I am aware of it, and it is very, very helpful in this regard.

So let me extend the invitation to you—and you obviously have an interest in it—that as soon as you are confirmed that we set up maybe some informal meetings to talk about ways in which we can, maybe through an informal structure in a series of meetings with Members, begin to talk about what are some of the areas of interest, again based on the Committee agenda and calendar here, and I will talk with the Chairman who again I know of his interest in this area. Hopefully we can work very closely with you.

Last, and a very quick question to you and I will be through my questioning. The Chairman and others in the Administration like Secretary Bentsen on regulatory consolidation has been a major issue.

I think there are some very valuable points in the consolidation proposals. There were some obvious concerns reflected in news stories appearing today on this sort of tug of war between Treasury and the Fed.

This has gone on now for a few weeks, and I will just speak for myself: I am getting tired of it. I expressed some concerns that I thought were legitimate about who was going to prevail in all of this, but there are some very sound and important principles incorporated in the consolidation bill that the Chairman and others have introduced.

We are getting late in this year, and now there is talk about the House not moving on this. But let me use the opportunity here with you in a confirmation hearing—again, you are not a member of the Fed yet, but this Senator is losing patience very quickly.

I would strongly urge at some point here that we just move forward. I think the votes exist on this Committee. Then we can talk maybe in conference or something else down the road. But I think delaying this process and playing chicken with one another is not serving the interest of the consumers, the public, or the financial institutions of this country. I think it had better stop, and stop very quickly.

Mr. BLINDER. I will give you a very short answer to that question, which is an agreement.

When this developed as a bone of contention between the Administration and the Fed I was (and am now) in the Administration. When it became clear that I was going to be a nominee for the Fed, I recused myself from the details of this. So I am not up to the minute; I have deliberately not been up to the minute because

there are elements of this battle, as you have just said, that are in conflict between the Administration and the Fed.

It is my understanding that the Treasury and the Federal Reserve are very close to an agreement. Now if you ask me, does that mean 2 days, or 2 weeks, I just do not know because I am not in the midst of it; but very close to an agreement, which will, I think, achieve most of the objectives that various Members of this Committee are quite legitimately concerned with—having to do with consolidation, simplification, reducing complexity and costs both to the Government and to the banking system, and bringing greater rationality to the system. But at the same time, not writing the Federal Reserve out of the system so much that it starts to impair the Fed's ability to conduct monetary policy, to guard against systematic risk——

Senator DODD. Well, that is the point I made earlier. But what happened, it seems to me, is the Fed took that as sort of a green light that they did not have to talk. They misread my remarks entirely, if that was the interpretation.

I have heard that "we are close" so many times already, and then nothing happens. So again I am expressing my own view here, personally, because obviously other Members may have different points on this or different feelings about it, but this idea of who is ahead up here and sort of nose counting as to whether or not there is a danger of legislation is something I have lost patience with and I would just as soon move ahead and let us get the votes together here.

We can do it that way, but I do not think that is a very good way of proceeding, quite candidly. I would hope we could reach an intelligent agreement on what needs to be done. But more than an adequate time has passed now for that to happen. My view is that if that is not going to happen that way, then we will do it up here and move ahead. It is obviously the Chairman's call, but that is my own view.

The CHAIRMAN. I thank the Senator from Connecticut. This has been a long mating dance and it is time to sort of get it finished.

I am going to ask you a series of questions that I hope you can give me "yes" or "no's" on, because I want to establish this for the record. We can take a long time doing it, or we can do it efficiently. With two other witnesses coming, let's try to do it efficiently.

Mr. BLINDER. OK.

The CHAIRMAN. First of all, can I anticipate that you will work actively and aggressively to get a financial consolidation, a regulatory consolidation, plan together if you are confirmed here?

Mr. BLINDER. Absolutely.

The CHAIRMAN. You feel it is important?

Mr. BLINDER. Oh, yes. I would hope it is actually done before I am on the Board. If it is not, I will certainly, yes.

The CHAIRMAN. We can count on you to get your shoulder to the wheel in getting that done?

Mr. BLINDER. Yes.

The CHAIRMAN. May I also ask, too, with respect to the Fair Lending Laws and access to credit on a fair basis and the problems we have seen with the Boston Fed's study and other things, can we count on you to be an aggressive, forceful voice on making sure

that all of the fair lending laws are being enforced vigorously at the Fed, including the Community Reinvestment Act?

Mr. BLINDER. Yes, Senator. Those laws are on the books, and I think Congress put them there for very good reasons.

In the case of Fair Lending, I think there are mostly enforcement issues. In the case of CRA, I think there are mostly, at this point, rulemaking issues that need to be done. And the Federal Reserve has the responsibility to enforce these laws as best it can. Absolutely.

The CHAIRMAN. So we can expect some active, vigorous leadership from you on that front?

Mr. BLINDER. Yes, sir.

The CHAIRMAN. All right.

Now on derivatives, we are having a hearing in this Committee on May 19, 1994. I am concerned about the derivatives, partly because I cannot find anybody out there who can convincingly explain to me that they understand exactly what is going on. That starts with the Chairman of the Federal Reserve who in public settings has indicated that these are very hard to fully comprehend and understand, but many, many others.

The number that is used is that there is something on the order of $10 trillion in notional value out there in the form of derivative transactions now.

I am of the view—which is I think sort of a generally held view—that part of the instability of the long-term bond market recently was when there was an unwinding of some of these derivative positions because of the sharp interest rate fluctuations. A lot of the traffic made its way into the long bond market. So you were seeing positions being liquidated one way or the other and seeing an abnormal sort of burst of activity in that area.

I think that surprised a lot of people, that you could maybe have a systemic problem in the derivatives area where, if suddenly there were a traffic jam of people wanting to exit positions and take losses before losses got bigger, that you would suddenly see this bulge of activity and this distortion over in the long bond market.

That to me is another reason for us to understand what is going on here and what the volume is that, under a slightly different set of circumstances, might descend upon us in a hurry, and what the implications and complications might be.

What I am most concerned about is whether, among other things, if private players can take losses and want to take risks or create the possibility of large losses, that is one thing; but to the extent that we start to edge over into an area where the system itself would have a hard time clearing all of this activity in a very short space of time, or by the end of the day in an international financial system that is cross-connected now, that to be is a source of great concern.

Sometimes these things happen without our knowing that they happen, that they can build up to point where suddenly you are into a new condition that, until the test comes you are not quite sure how the system will work.

I think we have to get on top of this derivatives' issue, and I think there has been too much complacency, quite frankly, in the view that somehow markets will sort of work things out in such a

way that, once way or another, we can take the moments of maximum stress. We have to be sure of that, given the enormous buildup in value and the fact that it is coming back through now parts of the banking system.

There are sharp differences of opinion between the regulators on this. I am hearing different levels of concern from different regulators, and there is a lot of ideology sort of washing through this.

I think we have to understand exactly what the implications might be in terms of just the ability of the system to handle the risk that has now been created that way.

I do not see this exactly as easily resolved offsetting risk. I am all for the hedging operations. I do not disagree with Senator Dodd in that area. But the whole question of what we can manage in a short period of time without getting cardiac arrest in part of the system is a different problem and I am concerned about it.

I would like your pledge that you will take what I consider to be superior technical knowledge and experience and zero in on that problem. Can I ask you to do that? Can I expect that you will?

Mr. BLINDER. Yes. I would be delighted to. This is a very serious issue. I think you phrased it quite appropriately. We do not quite know how serious this might be. We need to learn a lot more.

There are very few responsibilities of the Federal Reserve more fundamental than safeguarding the payments' mechanism. If you start having difficulties in the payments' mechanism, then all kinds of things could happen. We must really be sure that that never happens.

I do not know as much about this market as I will in a month. I know something about it already. I will know a lot more than I do in a month.

Just so you understand, I do not come to such issues either with a pure laissez faire attitude, that the government should never do anything about any of these things, nor do I come to these issues with an attitude that the Government should always be regulating everything.

We need to look at these markets. There are things that Government ought to be doing and probably things Government ought not to be doing. But it is one of the big questions facing the financial system right now. So I am very happy to say "yes."

The CHAIRMAN. One final thing for me.

I am concerned about the buildup of consumer debt and the stress that a lot of consumers are under with income streams that are not as strong maybe as they should be.

There are a lot of families today where both mother and father are holding as many as two or three jobs each to try to aggregate enough income to be able to provide enough for their family. We are all familiar with what some of the problems have been out on the job side.

But as I look at the buildup of consumer debt in all of its forms—credit card debt, these home equity loans which are out there where people financed houses and got in using adjustable rates when rates were quite low—I am concerned about the degree to which there is a buildup of pressure of consumer debt on the back of a lot of sort of citizens out there that may now pose an economic

concern for us. Have you looked at that? Do you have a view on that? How would you assess that at the moment?

Mr. BLINDER. I have looked at that a little bit, Senator I need to look at it more. I certainly recognize the legitimacy of the concerns that you are pointing to.

It is the case that the consumer debt burden is now a bit lower than it was a year or two ago. Part of that is due to lower interest rates which, as you just said, are somewhat reversing right now.

So the fact that it went down due to lower interest rates should not let us forget the fact that it can go back up again due to higher interest rates. That is certainly one of the things that members of the FOMC have to keep on top of. There is no doubt about that.

The CHAIRMAN. Well take a look at that, if you would, as well. We will have you back at some point, and at that time I am sort of signaling now the questions that I am going to pursue with you then and expect you to have a much deeper sense for.

Senator Sarbanes.

Senator SARBANES. Mr. Chairman, I have no further questions. I would just note the fact that the GAO is about to submit a report to us on May 18 with respect to derivatives, and I assume we will be hearing from the Comptroller General at that time with respect to this issue.

The CHAIRMAN. Senator Dodd.

Senator DODD. No further questions.

The CHAIRMAN. Thank you, very much.

We may have some additional questions for the record and from other Members who were not able to be here today.

We thank you very much. We look forward to moving your nomination along as quickly as we can.

Mr. BLINDER. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Let me excuse you now and call our next nominee.

Mr. Wallman, please come forward and be seated.

STATEMENT OF STEVEN M.H. WALLMAN, OF VIRGINIA, TO BE A COMMISSIONER OF THE U.S. SECURITIES AND EXCHANGE COMMISSION

The CHAIRMAN. We will resume now. The Committee will consider the nomination of Steven Wallman to be a Commissioner of the Securities and Exchange Commission.

Mr. Wallman has an outstanding legal background. Since 1986 he has been a partner in the Washington, DC, law firm of Covington & Burling. He graduated in 1978 from Columbia University Law School where he was a Harlan Fiske Stone Scholar. He holds bachelors and masters degrees from MIT. MIT is doing very well here this morning.

His nomination has received widespread support.

I worked with Mr. Wallman when I served as Chairman of the Securities Subcommittee in 1987 and 1988, and I know him to be a distinguished lawyer and a conscientious public servant, and I am very much in support of his nomination.

Senator Dodd, did you want to make a comment?

Senator DODD. If I could, Mr. Chairman, let me join you in welcoming Mr. Wallman before the Committee.

In many ways, Mr. Chairman, the SEC has one of the broadest and most important assignments of any governmental agency charged, as you well know, with ensuring the honestly and efficient operation of our capital markets.

The SEC oversees the securities industry and the many thousands of professionals who work in the industry. It also oversees the operation of mutual funds and other investment companies, an area which has become critically important to average households in recent years.

The SEC has always been creative in trying to make markets function better. It has been quick to tackle difficult issues when it believes the protection of investors or the integrity of the market is at stake. The challenges are greater now than they have ever been. It is an exciting time, I would say, for Mr. Wallman to be a Commissioner in an agency engaged in complex and important issues.

I am pleased to say that in my view you are highly qualified to take on this job. I think President Clinton has made a very fine selection with your nomination. You certainly have a background, as the Chairman has already pointed out, that makes you intellectually qualified to handle the job of a commissioner. Obviously it is not just a question of intellect; it is a question of having a sense of values to what is important along with a sense of balance.

I noted in your prepared remarks—and I may not be able to stay for the entire process here—but in your prepared remarks on page 3 you say:

> Entrepreneurs raise money on the basis of a dream and a promise. And when stock prices do not always follow the expected path, investors justifiable, want to know why. Distinguishing between fraud and mere changes in circumstances is not always easy. But we must try harder, lest we encourage frauds and taint our markets on the one hand, or stifle innovation and information and capital flows on the other.

You know Senator Domenici and I have legislation in the area of litigation reform in the securities industry. The number of cosponsors are growing almost on a daily basis, the people interested in this.

I would argue the system is broken. When investors are recovery 6 cents on the dollar in class action suits and the attorneys are collecting outrageous sums, then something is wrong.

When computers generate complaints—I looked at a complaint the other day where the computer screwed up. Half the complaint talked about one defendant and the other half of the complaint talked about another because the computer messed up.

There is something very wrong with the system where merely on fluctuation, mere fluctuation, you get that kind of activity. There is a growing interest in that here. We would very much like to have the SEC's support and involvement with this.

I noted this morning's New York Times with regard to the Supreme Court decision recently on aiding and abetting—excuse me, The Wall Street Journal, on the aiding and abetting issue, that some of these cases are being dismissed.

I am going to be very interested in how that is working. That is an important decision by the Supreme Court. We are going to have a hearing on it next week to look at all of this, but I would hope the SEC would slow down before dismissing cases and not over-in-

terpret what aiding and abetting means here to create more of a problem than is necessarily the case.

Because I know there is some hostility and opposition to the securities litigation reform proposals we are talking about, and I am not going to be fooled by all of a sudden dismissing a lot of cases in that area.

There are not a lot. We are talking about 10. But I would like you to hold up until we decide exactly what that decision meant and how broad it should be interpreted in my view before trying to expand it beyond the scope of the decision itself.

Then, obviously, I would be very interested in the SEC's ideas and suggestions on the securities litigation reform proposal that is before the Committee.

So with that, Mr. Chairman, I thank you very much for giving me a chance to welcome our witness. I really wish you well and look forward to working with you as the Chairman of the Securities Subcommittee.

We have had a wonderful working relationship, in my view, with the SEC in the past. We have had some great successes legislatively up here, and I am looking forward to a continuing positive relationship.

The CHAIRMAN. Very good.

Let me ask you now to stand and raise your right hand.

[Witness sworn.]

The CHAIRMAN. Do you swear that the testimony you are about to give is the truth, the whole truth, and nothing but the truth, so help you, God?

Mr. WALLMAN. I do.

The CHAIRMAN. Do you agree to testify before any duly constituted Committee of the Senate?

Mr. WALLMAN. I do.

The CHAIRMAN. Very good.

I know you have some family members here. We would like you to introduce them and then make your opening statement.

Mr. WALLMAN. The person behind me is my wife, Kathy. I would like to introduce her.

The CHAIRMAN. Hello, Kathy.

[Mrs. Wallman stands.]

Mr. WALLMAN. And my mother is sitting next to her, Doris.

The CHAIRMAN. Nice to have you.

Mr. WALLMAN. Mr. Chairman, Members, it is with great pleasure that I appear before you today. It is an honor to have been nominated by President Clinton to serve as a Commissioner of the Securities and Exchange Commission.

I would like to thank you, Mr. Chairman, the other Members of the Committee, and the Committee staff, many of whom I have worked with in the past, for your consideration of my nomination.

My first recollection of the Commission dates back to when I was about 6. I remember my father talking to me outside of a subway station in Manhattan near the apartment where we lived. He was talking about what he did. He was a lawyer practicing alone, predominantly handling securities and corporate matters. He had some issue before the Commission and he was talking about how tough the agency was and how dogged in the pursuit of its mission.

And, when like 6-year-olds sometimes do, I said something to show my dad that I was on his side. He told me how fair and right the Commission was and how terrific a job they were doing. That started me down the road of understanding how good a Federal agency can be, a road that has led me to share the tremendous respect that people throughout the world feel for the Commission. If my father were alive today, I know he would be very pleased about my nomination.

The Commission's unswerving determination to protect investors has contributed to the creation of the largest, most efficient and most envied capital markets in the world. By ensuring the integrity of those markets, entrepreneurs find capital at reasonable cost, investors retire wealthier, and companies produce products, provide jobs, and improve the standard of living. In a capitalist system, protecting investors and preserving market integrity increases the incentives for investment, decreases the cost of capital, and enhances the potential of society to do better for all of its citizens, even those who may currently lack the wherewithal to invest.

For the past decade and a half I have practiced law as a corporate and securities attorney fascinated by the evolving potential of our system to improve our lives. As a Commissioner I would work to promote that potential and to try to continue to convert it into reality. I would do so here with the advantage of having the exceptional leadership of Chairman Levitt and Commissioners Schapiro, Roberts, and Beese.

The challenges facing the Commission and the markets at any one time vary with changes in the world. Currently, new communications technologies, computer capabilities, and quantitative methods allow for the creation of new instruments that can be traded globally and promise higher returns at lower risks. They may not always work as intended, but mostly they do. With new products come new issuers providing additional choices to investors and services to end users while blurring, and sometimes erasing, the traditional lines that compartmentalize the financial sector. If confirmed as a Commissioner, I would hope to work closely with the banking regulators, the CFTC, and others on such matters which are of interest to all of us.

Entrepreneurs raise money on the basis of a dream and a promise. And when stock prices do not always follow the expected path, investors justifiably want to know why. Distinguishing between fraud and mere changes in circumstances is not always easy. But we must try harder lest we encourage frauds and taint our markets on the one hand, or stifle innovation and information and capital flows on the other. With an open mind, if confirmed, I would make it a priority to learn more about these issues and work with this Committee as it wrestles with a difficult task.

We must work to ensure that emerging democracies have the benefit of our capital markets' experience and the advantages of the expertise of our capital markets participants. There are no examples of major, sustained democracies without capital markets' participation. I believe the two are inextricably linked. If confirmed, I look forward to working with those around the world who share a similar view.

Our markets are very efficient and very transparent, and they consistently improve. If confirmed, I would like to devote attention to lowering further the cost of capital and ensuring better capital availability for all our companies, small as well as large, to help them compete and grow and to help them produce products and provide services that benefit us all.

At heart it is the promise of what Main Street can do for Wall Street, and what Wall Street can do for Main Street, that is so alluring to me and what makes the opportunity to work as a Commissioner and at the Commission such an honor.

Mr. Chairman, if confirmed by the Senate I look forward to working with you, your colleagues on the Committee, and the Committee staff. I will be honored to have an opportunity to be part of a team that protects investors, preserves and enhances the integrity and efficiency of our markets, facilitates capital formation, strengthens industry, and thereby improves our society and betters our world.

Thank you, and I would be pleased to answer any questions you may have.

The CHAIRMAN. Let me just pose a couple of questions here, and then Senator Dodd may have some as well.

Last year the Director of the SEC's Division of Enforcement testified for the Agency regarding the importance of these private securities' fraud suits which Senator Dodd has touched on here this morning. At that time he said, and I quote:

> The implied private right of action under Section 10(b) and Rule 10B–5 thereunder is critically important to the effective operation of the Federal Securities law.

Two weeks ago the Supreme Court ruled that private investors may not sue parties who aid and abet securities frauds under the antifraud provisions of the Federal securities laws. I am wondering, does this decision unduly restrict the usefulness of shareholder antifraud suits. If so, would you recommend that the Congress address this decision through legislation?

Mr. WALLMAN. The Central Bank of Denver case that you are referring to is a 5 to 4 decision. The minority, in its dissent, stated that in their view the Commission's enforcement powers with regard to aiding and abetting liability would be adversely affected by the reasoning of the majority. The majority was silent on that matter.

The Commission has consistently taken the position that the activities of private litigants in connection with enforcing the securities laws are necessary, appropriate, and critical elements in ensuring investor protection and in ensuring that the markets are efficient and have integrity.

What effect the Central Bank case will have with regard to the Commission's enforcement power, and what action the Commission should take at this time, are still being reviewed within the Commission in contemplation of the testimony that the Commission intends to give before Senator Dodd's Subcommittee next Thursday.

I note that in connection with The Wall Street Journal article today there was a statement from Barry Goldsmith, the chief of litigation of the Division of Enforcement, that he would be surprised if the number of cases affected by that decision exceeded much more than ten.

But I have been requested, and I agree with the request, that it would be inappropriate for me at this point either to second-guess or anticipate the Commission's testimony on Thursday. So, for any further statements I would defer to the Commission's planned testimony.

The CHAIRMAN. Let me just ask you something, too, with respect to derivatives. You were here for the earlier discussion.

I think it is fair to say that Chairman Levitt has also expressed some concern about this, and I have been reading news accounts of that just recently, as you have. But when we see sophisticated players like Procter & Gamble and others taking big losses in this area, I think it is a signal that we need to know a lot more about it.

I am not sure who today, if anyone, has the financial regulatory know-how and sort of reach to make sure that we know what is going on, and that what is going on is within the broad bounds of sound public policy and, for that matter, some private policy.

I am also concerned about the Kidder, Peabody episode where substantial losses associated with derivatives were hidden for some period of time, even within a very sophisticated organization, and that suggests to me that the firms themselves do not have adequate internal controls, let alone in the sense of from the outside and the outside regulatory view as to what may be at play here.

I am also wondering whether the Working Group on Financial Markets, consisting as it does of the Treasury, the Federal Reserve, the SEC, and the CFTC, can by itself provide sufficient coordination in the area of derivatives.

So what I would like now—and you can elaborate on the record this answer, because we are going to be pressed for time today, and because we have got another nomination to handle as well, but I do not want you to feel squeezed by the time in terms of the response that you give to this question because this is a very serious question.

That is, I would like to know your views as to what additional steps the SEC ought to be taking in this area, either separately or in combination with others, and how you see this issue, whether capital requirements need to be harmonized in some way here where we really are sort of playing with a set of rules that are more uniform in terms of across the various playing fields with respect to the different regulatory bodies.

Mr. WALLMAN. Senator, the whole issue of derivatives is one that is exceedingly complex for a number of different reasons that have different impacts.

First, the term "derivatives" itself is applied to all sorts of instruments, some of which have been around for an awful long time—options, for example, that have been around for centuries—and that we understand very well, or are familiar with how the markets react, having been used for hedging in certain cases and speculation in other cases, to new instruments that have been around now for only a few minutes.

Nobody quite knows what these new instruments will do, not because they are necessarily so complex no one can figure them out, but nobody knows for sure how the market will respond and react.

The question of market risk that Alan Blinder mentioned earlier in addition to credit risk is clearly there. So are questions that are similar to the kinds of things that you had mentioned earlier with regard, for example, to interrelational risk and liquidity risk.

There are a variety of other issues that are called into play with regard to derivatives. On the other hand, I think we need to recognize that derivatives have also been used for hedging and to avoid risk, and that in part what derivatives do is allow those who are willing to pay to avoid risk to do so while permitting others who are willing to be paid to assume risk also to do so.

If one were to limit or eliminate the ability of persons to assume risk, you also limit or eliminate the ability of others to avoid risk.

So to some degree we need to be careful with regard to this market. It does constantly change and it is dynamic.

With regard to how the market works, we need to recognize that it is also global. So whatever we do here, whether it be within the Working Group or otherwise, we need to take into account how our foreign regulators will react as well as what measures could be put into place with or without them.

The CHAIRMAN. Let me ask you this: Is there a risk that derivatives could operate in such a fashion, or that certain players could operate in such a fashion that you could get a kind of a pyramiding effect, and that in a sense you sort of lever up investment positions so that you do not just have a first-order issue of a winner and loser on one side or the other of a transaction, but that you can get a layering of transactions and an accumulation of risk in such a way that in effect you can create an amplification and a magnification that may bring something else into play that one would not think about just in a sort of one-dimension, across-the-table, two-party transaction?

Mr. WALLMAN. People have certainly speculated, and some believe they have observed, that exact phenomena in various cases. Whether it is sufficiently widespread for one to try to fix on a regulatory basis worldwide is an interesting question.

The CHAIRMAN. Can we get an answer to that?

Mr. WALLMAN. I think we have to get an answer to that. I think that some of the steps that have already been taken, the G–30 Study, the GAO study that will be issued shortly, the CFTC reviews that have already occurred here, the Commission's own internal reviews that are occurring are all aimed—and Alan Blinder mentioned the Fed is also gathering information—are all aimed at getting additional information.

In addition, the FASB importantly is putting forward a project to try to improve disclosure so that end users and others dealing in derivatives will be presenting better information and be in a position to have better internal controls with regard to their own risk.

You mentioned Kidder. I will not comment on the Kidder case particularly, but clearly the question of internal controls is one that the Commission for a long time has thought was critical. To the extent that you have major industrial companies that believe they may not have known what was transpiring with regard to these instruments, it is imperative that I think those companies have better internal controls.

The CHAIRMAN. Senator Sarbanes.

Senator SARBANES. Thank you very much, Mr. Chairman.

The first question I want to put to you is whether you intend to serve out the full term.

Mr. WALLMAN. Yes. Actually, the full term here is a truncated term as it currently stands, and I certainly do intend to fill it out.

Senator SARBANES. When does it truncate?

Mr. WALLMAN. It is a continuation of the term left by Commissioner Fleishman. It ends in June 1997.

Senator SARBANES. June 1997.

Mr. WALLMAN. Three years or so from now.

Senator SARBANES. Would you entertain continuing to serve?

Mr. WALLMAN. Yes.

Senator SARBANES. After that, I mean——

Mr. WALLMAN. Yes.

Senator SARBANES. —for yet another term?

Mr. WALLMAN. Yes, I certainly would.

Senator SARBANES. Well I am very pleased to hear that. Unfortunately, I think increasingly serving on these Commissions is being used by people as a stepping stone to other things instead of being seen—not necessarily as the culmination of a career; I do not want to put it that way—but that you have risen to a very high level which warrants assuming this very important public responsibility; and that that is what you are there for, to really serve the public, and it is not yet another item in one's curriculum vitae then to be used to sort of further them in some private career.

Of course you have established a very fine record as a partner in one of the Nation's leading law firms, so you obviously do not need this as a stepping stone in private practice; and in fact I am very pleased that we have been able to draw you into assuming this responsibility. I think Arthur Levitt needs people like you on the Commission with him. So I welcome the nomination and I welcome the response to that question.

I know we are under tight time pressures here, Mr. Chairman, and I am not going to pursue any substantive questions with Mr. Wallman.

Those are your two young sons there, I take it?

Mr. WALLMAN. No, those are——

The CHAIRMAN. Mr. Diehl's sons. We are going to get to them next.

Senator SARBANES. Oh, those are Mr. Diehl's sons? Well, I am jumping the gun.

[Laughter.]

I thought that——

Mr. WALLMAN. I can affirmatively deny that.

[Laughter.]

Senator SARBANES. I was struck by the story you told about the conversation you had with your father very many years ago. We hope that you are going to contribute to that standard he spoke about with respect to the Commission and the work it was doing and its responsibilities.

I wish you well in the task that lies ahead of you.

Mr. WALLMAN. Thank you, Senator. I have been looking forward to the opportunity to be in public service for an awfully long time.

That is why I came to Washington in the first instance, so this is quite a great honor and privilege for me.

Senator SARBANES. Good luck to you. Thank you.

The CHAIRMAN. Thank you very much. We appreciate the sentiment you just expressed.

We will have additional written questions for you for the record, I am sure, from other Members. That will conclude our questioning of you.

We thank you. Let me excuse you now and invite Mr. Diehl to come to the table.

Next we are moving to consider the nomination of Philip Diehl of Texas to be Director of the U.S. Mint.

Mr. Diehl is familiar to many of us because of his long and distinguished association with Senator—and now Treasury Secretary Lloyd Bentsen.

As was mentioned earlier by Congressman Pickle, he has served as Senator Bentsen's Legislative Director and later his Staff Director on the Senate Finance Committee.

I want to say at the outset that I strongly support your nomination. He comes before us today with outstanding qualifications and experience.

In addition to the previous service, he has also worked as a teaching assistant at Stanford; been a public policy and economic researcher for the Texas State Comptroller; worked for as a Constitutional law research consultant for Pillsbury Madison & Sutro in San Francisco; and served as the Director of Telephone Regulation at the Texas Comptroller's Office to the Texas Public Utility Commission. He has had other important duties, as well.

He is currently serving as the Executive Deputy Director of the Mint where, from all reports, he is doing an excellent job. I know him to be highly knowledgeable with respect to all aspects of the Mint, and we look forward to having you serve there in a distinguished way.

Let me now ask you to stand and take the oath.

Do you swear that the testimony you are about to give is the truth, the whole truth, and nothing but the truth, so help you, God?

Mr. DIEHL. I do.

The CHAIRMAN. Do you agree to appear and testify before any duly constituted Committee of the Senate?

Mr. DIEHL. Yes, I do.

The CHAIRMAN. Why don't you go ahead and introduce your family and your two handsome young sons there and your wife—or is that your daughter?

[Laughter.]

STATEMENT OF PHILIP N. DIEHL, OF TEXAS, TO BE DIRECTOR OF THE UNITED STATES MINT

Mr. DIEHL. This is my wife, Jacquita, and my son Michael, and my son Alex.

The CHAIRMAN. Nice to have you here.

Mr. DIEHL. Thank you, Mr. Chairman.

Senator SARBANES. I welcome those two young men, and I apologize.

The CHAIRMAN. You [speaking to Michael and Alex Diehl] will have to come up here and sit this chair when we finish so you can just see how it feels and see how it looks from this end. We will do that when we finish here.

Mr. DIEHL. Thank you very much, Mr. Chairman, Mr. Sarbanes.

It is an honor to come before the Senate Committee on Banking, Housing, and Urban Affairs as President Clinton's nominee to be Director of the United States Mint.

As you know, the U.S. Mint is one of the Nation's oldest Federal agencies with a history dating back over 200 years. Unlike the Treasury Department, of which the Mint is a part, the U.S. Mint traces its origins to Thomas Jefferson rather than his political and ideological rival, Alexander Hamilton.

Among his many other interests, Jefferson was a coin collector and had strong opinions regarding the type of coinage system the Nation would need to ensure the efficient flow of goods and services within its borders.

Out of his commitment to economic growth and equity, Jefferson authored, and advocated to eventual adoption by the Congress, the decimal coinage system we use today. He also founded the United States Mint during his tenure as the Nation's first Secretary of State.

Today the U.S. Mint has grown into a billion dollar a year international manufacturing and marketing enterprise with 2,200 employees, the largest coin production operation in the world. If the Mint were a private concern, it would be counted among the Fortune 500.

In 1993, the Mint produced over 14 billion circulating coins valued at more than $500 million and generating over $300 million in seigniorage profits to finance the Federal debt, making the Mint one of the few Federal agencies to generate a profit. Faster economic growth in 1994 will boost coin production demand by 25 percent to some 18 billion coins.

In 1993, the Mint also produced and sold some 40 million coins in bullion and numismatic markets around the world, generating another $40 million in profits for the Federal treasury and $20 million in surcharges for sponsoring organizations authorized by Congress to receive these funds.

All tolled, the Mint commemorative programs over the past decade have raised $250 million for sponsoring organizations, providing funding for the training of Olympic athletes, the restoration of the Statue of Liberty and the Statue of Freedom on the Capitol Dome, fellowships for study and teaching related to the U.S. Constitution, and to complete the circle in 1994, an endowment to preserve Monticello, the home of Thomas Jefferson.

These commemorative programs and the gold and silver bullion American Eagle programs play important roles in supporting demand in the U.S. gold, silver and copper mining industries, providing jobs for American miners and coin strip manufacturers, and allowing for controlled disposal of excess supplies from the Federal stockpile of silver.

In the process of making these contributions to the U.S. economy, the U.S. Mint has built the American Eagle into the most successful bullion coin program in the world, with the Silver Eagle taking

70 to 80 percent of the world market and and registering total sales of over 55 million one-ounce silver dollars. Likewise, the gold Eagle, after competing in world bullion markets for only 7 years, is now the world market-share leader with total sales of over 6 million ounces of gold.

If I am confirmed by the Senate as Director of the United States Mint, I intend to pursue three priorities during my term.

First, the Mint is one of three Treasury bureaus that has not received a clean audit from its outside auditors under the Chief Financial Officers Act. My first priority will be to implement an aggressive schedule of financial management improvements that will lay the foundation for the Mint to receive a clean audit within 2 years.

The CHAIRMAN. Good for you.

Senator SARBANES. Yes.

Mr. DIEHL. In fact, we have already begun this effort in the past 6 months and I can report that good progress has been made with the Mint obtaining an unqualified opinion on its manufacturing balance sheets.

Second, the Mint shares with this Committee a challenge on which I hope we can make progress in the near future: Finding a means of controlling the continuing proliferation of commemorative coin programs.

As the Congress recognized in 1992 when establishing the Citizens Commemorative Coin Advisory Committee, and again in a Sense of the Congress Resolution passed in 1993, the Congress is authorizing the production of a rapidly increasing number of coin programs into a shrinking market for commemorative coins.

This proliferation of coin programs is testing the limits of both collectors' willingness to buy and the Mint's ability to produce and market in a business-like fashion.

Last November Secretary Bentsen appointed the members of the Citizens Advisory Committee, which was created by Congress to provide advice on how to limit the number of commemorative programs. This Committee will produce a report before the end of this year recommending a 5-year plan of commemorations and suggesting additional actions which might be considered to address this matter.

Third, there are opportunities on several fronts for the Mint to increase its profitability and thereby make a larger contribution to financing the Federal debt, and increasing employment among the Mint's private-sector suppliers.

One opportunity is through the acquisition of more modern communications and production technology and the adoption of modern personnel management practices.

I am persuaded that in this regard the Mint is especially ripe for "reinvention," with a significant potential for productivity improvements and savings.

I believe there are opportunities over the mid-term to expand coin collecting into geographic and demographic markets that in the past have shown little interest in numismatics.

One reason the commemorative coin sales have declined over the past decade is that the Mint has invested little in expanding its

markets beyond the white males over 50 years of age who dominate our customer base.

We must develop marketing strategies that expand the appeal of coin collecting into younger and more ethnically diverse markets in order to respond to the rising demands in Congress for authorization of commemorative programs.

Finally, the Mint must secure the loyalties of its long-time customer base, as well as its new customers, by rapidly improving customer service, enhancing the artistic appeal of our products, and expanding the range of commemorative themes beyond the athletic, military, and veteran themes that have dominated coin programs over the past decade.

The Citizens Commemorative Coin Advisory Committee will address the matter of commemorative themes in its 5-year plan to be issued later this year.

The Mint has already begun a major effort to improve customer service by cutting in half average order fulfillment time and improving the responsiveness at our customer service center.

I want to take this opportunity in closing to thank President Clinton for the honor of this nomination, and Secretary Bentsen for his continuing support and confidence.

I also want to thank my wife and my sons for the patience with which they have accommodated the demands of life in official Washington over the last 3½ years.

That concludes my statement. I am happy to answer any questions.

The CHAIRMAN. Very good. Good statement. You have covered the waterfront, and I appreciate that.

I am going to just pose one question to you, and I am going to have you give me a brief answer. If you want to elaborate for the record, I would like you to do that.

We have a GAO report that suggested that the replacement of the $1 Federal Reserve Note with a $1 coin could save up to $395 million in production costs in the 14th year of a 30-year program. So this is a complex issue.

According to the GAO, key elements for the successful conversion to the $1 coin are, number one, elimination of the $1 paper note; a reasonable transition period; a well-designed coin; adequate public awareness of the change; and administrative and congressional support. So it is not a simple matter. Do you have a position regarding the $1 coin, yourself?

Mr. DIEHL. No, I do not. The Administration has not yet determined its position on the $1 coin, although it is under active consideration in the Treasury Department as we speak, as a matter of fact.

I think the GAO has it exactly right. We have had several failed experiments with $1 coins, the most recent being the Susan B. Anthony——

The CHAIRMAN. Right.

Mr. DIEHL. —and the Mint is very sensitive about what it believes are the requirements necessary to have a successful program.

There are foreign governments that have made this transition and they have shown us how to do it if we choose to do it. I think

it is absolutely essential that we make a commitment up front to eliminate the $1 bill in order to ensure the success of the $1 coin, and also to have an appropriate transition period.

I say that one concern, a parochial concern from the point of view of the Mint, regarding the current legislation pending in Congress is that it only provides for an 18-month transition period, if I recall correctly. I think we probably need something closer to 30 months to make that a reality.

We also need to make a commitment to spend the funds necessary in order to conduct a public relations campaign to prepare the American people for the transition to a $1 coin. The Canadians did that when they introduced the maple leaf, and I think it went a long way to smoothing the path.

The CHAIRMAN. Thank you, very much.

We will give you other questions for the record. I think we have covered the ground we need to now, so I am going to put the Committee into recess and I am going to invite you to bring your boys up here and let them look at things from this end of the room.

Mr. DIEHL. Thank you, very much.

The CHAIRMAN. The Committee stands in recess.

[Whereupon, at 12:35 p.m., the Committee was recessed, to reconvene upon the Call of the Chair.]

[Prepared statements, response to written questions, and additional material supplied for the record follow:]

PREPARED STATEMENT OF CONGRESSMAN J.J. PICKLE

To the Senate Committee on Banking, Housing, and Urban Affairs

Introducing Philip N. Diehl to be the Director of the United States Mint

Chairman Riegle, Members of the Committee, I am pleased to appear before you today to introduce Philip N. Diehl, President Clinton's nominee for Director of the United States Mint.

Philip has amassed exceptional experience and expertise in both the public and private sectors. He has been Executive Deputy Director of the Mint since last September and he has served Secretary Bentsen as Counselor and Chief of Staff. Prior to moving to the Treasury on January 21, 1993, he was Staff Director of the Senate Finance Committee and Legislative Director for Senator Bentsen. These two offices have had a reputation for being run according to Senator Bentsen's business-like philosophy, and in my judgment Philip was largely responsible for maintaining that high level.

Before joining Senator Bentsen in 1991, Philip worked in both the public and private sector of the telecommunications industry. He was Vice President of Regulatory Affairs for International Telecharge Inc., a long distance telephone company in Dallas, Texas, and was Director of Telephone Regulation for the Texas Public Utility Commission. He also has had extensive experience in the management of public and fiscal policy research with the State Comptroller's Office in Austin. He will bring practical business experience and extensive knowledge of the public sector to bear in this new job as Director of the United States Mint.

I might add that as Director of the Mint, Mr. Diehl will be leading one of the few Federal agencies that actually returns a profit to the United States Treasury. Having watched his work on the funding formulas in the 1991 Highway Bill, I have no doubt he can do FOR the Federal Treasury what he has helped Senator Bentsen do for Texas with those funding formulas. (By the way, Mr. Chairman, I believe the State of Michigan was one of the big winners under those reforms.)

I am pleased to note that Philip is a former constituent of mine as a long-time resident of Austin, Texas. In addition to his career in State government, he earned a Master of Arts in Government at the University of Texas at Austin.

Philip Diehl's experience, knowledge, and energy make him uniquely suited to the directorship of the United States Mint. He is a strong advocate for making Government more efficient and responsive. Reinventing the mint is a big job, but as we say down in Texas, it ain't no step for a stepper, and Philip is a stepper. Let's face it, anybody capable of being Lloyd Bentsen's top hand is capable of handling just about anything!

I am delighted to appear before you today, Mr. Chairman, and to formally introduce Philip Diehl to you as the President's nominee to be Director of the United States Mint.

PREPARED STATEMENT OF SENATOR ALFONSE M. D'AMATO

Mr. Chairman, thank you for holding this hearing on the nominations of Alan Blinder for Vice Chairman of the Board of Governors of the Federal Reserve, Steven Wallman for Commissioner of the Securities and Exchange Commission, and Philip Diehl as the Director of the Mint.

Mr. Blinder is not a stranger to this room. About 9 months ago he sat at that very table for his confirmation hearing to be a member of the President's Council of Economic Advisers. Even though the move from the Old Executive Office Building to the Federal Reserve Board is a short move distance-wise, the move job-wise will be miles apart. In your former position at the CEA, you, along with Ms. Tyson and Mr. Stiglitz, were given the task of advising the President on economic policy. However, your suggestions did not throw the financial markets into an uproar. The determinations you make at the Federal Reserve will affect a lot of people. The world financial markets will hang on every word you, the other governors, and Mr. Greenspan, will say. You cannot take that power for granted.

Mr. Wallman, I welcome you to the Banking Committee. In your qualifications, you state that you are deeply committed to protecting and enhancing the interests of the investing public and to promoting the ability of American business to create jobs and to enhance the standard of living within our market structure. I agree with this philosophy and I hope that you will be able to meet that goal. The SEC must play an active role in seeing that people feel safe and secure in investing in business.

Looking at passed and proposed legislation dealing with the minting of coins, the need for a capable and responsible director for the Mint becomes obvious. During the past two Congresses, there has been a proliferation of commemorative coin programs. As these projects go into effect, it is imperative to have a competent individual who can accurately foresee the implications of these coins and effectively manage the operations of the Mint.

Since Mr. Diehl has joined the Mint's staff as Executive Deputy Director, he has taken an active role in the formation of the Citizens Commemorative Coin Advisory Committee by serving as its Chairman. I, along with my colleagues, look forward to the report the Advisory Committee is preparing.

There is reason to believe, based upon his performance to date that Philip Diehl is qualified for the position of Director of the Mint.

Again, I want to thank the Chairman for promptly scheduling these nominations.

PREPARED STATEMENT OF SENATOR CHRISTOPHER J. DODD

On the Confirmation of Alan S. Blinder as Vice Chairman of the Federal Reserve Board

I'd like to welcome you here today Dr. Blinder.

You are without a doubt, superbly qualified for the position of Vice Chairman of the Federal Reserve Board. I think we are fortunate to have someone of your caliber ready and willing to serve in such an important position.

The Committee is familiar with your record and your views. It was less than 10 months ago that you were here before us as a nominee to the Council of Economic Advisers. However, since you last appeared that relatively short time ago, the domestic and international economic landscape has changed quite a bit.

The Federal Reserve has raised short-term interest rates three times. We have had periods of intense volatility in our financial markets. International trade tensions with Japan have increased considerably. The dollar has slid to historic lows relative to other currencies. And these are just a few of the more significant developments in recent months.

It is an enormously challenging time for economic policymakers. Getting your arms around a domestic and international economy which are more intertwined than ever before is no easy task.

The instruction manual that the Fed and others have used to steer the economy for many years is outdated, but we're not exactly sure in what ways. In many respects, we're simply no longer sure what button moves what lever.

This is particular true in terms of monetary policy. And it brings me to my concern about the recent Fed interest rate increases. As a Member from a State and a region that have been economically devastated over the last several years and have yet to recover, I am very concerned about the impact of the recent rate increases. Whatever, economic recovery may be under way—and I have doubts about it in my State—it is going to be strangled.

How sure is the Fed about the nature and origins of the "inflation" it is fighting. Are our traditional gauges of inflation and economic growth still relevant? Have we identified the right enemy and are we fighting the right battle?

I am very interested on your thoughts on this matter.

PREPARED STATEMENT OF ALAN S. BLINDER

Nominee for Vice Chairman of the Board of Governors of the Federal Reserve Board

Mr. Chairman and Members of the Committee, this is the second time in less than a year that I have appeared before you as a nominee, and I want to thank you once again for the speed with which you are handling my nomination. I know the Committee has a crowded agenda, and I appreciate the prompt attention. There is important work to be done at the Federal Reserve, and, with the Committee's approval, I look forward to getting down to business as soon as possible.

I would like to say, first, that I am deeply honored that President Clinton has nominated me to be Vice Chairman of the Board of Governors. Having spent much of my adult life watching monetary policy from a distance and studying its effects on the economy, I am keenly aware of how difficult the Fed's job is—and how important. Millions of Americans who haven't the slightest idea of what the Fed does are

nonetheless affected by its decisions. So I approach this assignment with a mixture of humility and awe—and with the utmost seriousness.

Because I was before this Committee so recently, I will be very brief on personal biography and get right down to my views on monetary policy and the role of the Federal Reserve.

BIOGRAPHY

I was born in New York, but since going to college in 1963 I have lived most of my life in the Third Federal Reserve District (Philadelphia). My A.B. degree from Princeton University, M.Sc. from the London School of Economics, and Ph.D. from MIT are all in economics. From 1971 until I joined the Clinton Administration in January 1993, I taught at Princeton; and I am still a faculty member there, on unpaid leave of absence. My academic writings include more than 50 articles and several books about macroeconomics or monetary policy. I am also the co-author of a textbook from which well over a million students have learned introductory economics. Finally, for almost 12 years I wrote monthly newspaper and magazine articles on a wide variety of economic issues.

At present, I am serving as a Member of President Clinton's Council of Economic Advisers, where macroeconomic monitoring, forecasting, and policy are among my major responsibilities. Needless to say, my CEA job has involved me in many discussions of interest rates and monetary policy, including periodic talks with Federal Reserve governors and staff. So I am quite familiar with current and prospective future monetary policy issues. While I am rushing to educate myself on the many legal and regulatory issues facing the Fed, I would like to apologize in advance if I am not as knowledgeable on these matters as I should be—and soon will be.

MONETARY POLICY METHODS

As I mentioned, monetary policy is an arcane art, understood by few but affecting many. It is one of the two major tools the Government has for influencing the pace of macroeconomic activity—the other being fiscal policy. In today's environment, however, with the macroeconomic aspects of fiscal policy all but locked in for 5 years by OBRA93, monetary policy must bear almost the entire burden of stabilization policy.

Monetary management was never an easy job. And, nowadays, with the financial markets more complex—and more global—than ever before, it is harder than ever. Furthermore, as Chairman Greenspan has noted, the traditional monetary aggregates are currently of relatively little use as guideposts. So the Fed really has no choice but to watch everything and make its best judgments about when the economy needs to be spurred on and when it needs to be reined in to guard against inflation. Nowadays, changes in the Federal funds rate are the normal vehicle for putting such decisions into effect.

This brief characterization of monetary policy seems to encapsulate the way the Fed has been conducting its business of late, and it is a framework with which I feel quite comfortable. At this juncture in history, no one on the FOMC can afford to be dogmatic, nor to swear allegiance to any one particular indicator. Paul Samuelson once said that the Lord gave us two eyes so that we could watch both interest rates and the money supply. Thanks to the explosion of electronic information gathering and processing, we now have, in effect, many more than two eyes. That's fortunate, for we need to be watching many things at once.

GOALS OF MONETARY POLICY

But the techniques of monetary policy are far less important than the objectives. What should be the Fed's goals? To me, this is a simple question, for Congress has prescribed them in the Federal Reserve Act, as amended: "to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates." Let me say a few words about each.

Maximum employment: "Maximum employment" cannot be taken literally. In principle, every person in America could be at work; but this is hardly desirable. A large dynamic economy like ours will always have millions of people who are, in a real sense, between jobs. Some are looking to improve their prospects; some have recently lost their jobs and are looking for new ones; some have skills that do not match the available jobs and need retraining; and so on. Economists say that, at any point in time, the economy has a "natural rate of unemployment" which, to a first approximation, cannot be changed by monetary or fiscal policy. So I interpret the goal of "maximum employment" to mean limiting unemployment to this natural rate.

Moderate long-term interest rates: To a significant degree, "moderate long-term interest rates" follow directly from stable prices; and I will dwell on that in a moment. But, in addition to the inflation component, interest rates have a real component.

The plain fact is that, while monetary policy has a profound effect on long-term inflationary expectations, its influence on real long rates is indirect and muted. Other factors, such as the balance of private saving and investment and prospects for the Federal budget, have larger effects on real long rates. In this respect, I have been proud to be associated with the Clinton Administration's efforts to bring down the Federal budget deficit.

Stable prices: "Stable prices" translates directly to low inflation. Some would even say *zero* inflation, but this is a more elusive concept than it seems. Different price indexes offer different measures of inflation. For example, over the last year the core CPI has increased 2.9 percent; the core PPI has increased just 0.4 percent; and the GDP deflator is up 1.9 percent. These numbers are all different, but they all share one thing in common: They are at or near the lowest readings in a generation. We have, indeed, made great strides in reducing inflation, and this achievement should neither be forgotten nor belittled.

Another set of complications in defining stable prices stems from measurement problems which make price indexes overstate inflation. Among these are difficulties in adjusting for improvements in quality and for new products, and consumers' tendencies to shift spending toward products and sales outlets that charge lower prices. Analysts believe that the CPI, for example, may overstate inflation by between 0.5 percent and 1.5 percent per annum. So, just as zero *measured* unemployment is an inappropriate translation of "maximum employment," zero *measured* inflation is an inappropriate translation of "stable prices."

Chairman Greenspan has said that his working definition of stable prices is when inflationary expectations do not play a role in household and business decisions. I have often used a similar definition: When people stop talking about inflation. By either of these definitions, the United States now looks to be close to, but not quite at, stable prices.

Since I have been accused of being "soft on inflation," I would like to take a few minutes to clarify my views on the subject.

First, it is clear that lower inflation is always better than higher inflation—at least until we reach zero "true" inflation. In a book of mine which has been cited as evidence that I am a "friend" of inflation, I wrote:

> Inflation does indeed bring losses of efficiency. It also makes people feel insecure and unhappy. We would no doubt be better off without it. (*Hard Heads, Soft Hearts, p. 51)*

I'm not sure how that makes me a friend of inflation. To me, the only real questions are: How low should we try to push inflation and how fast? At what point is the benefit of further inflation reduction worth the incremental cost of achieving it?

Second, there is no magic bullet for fighting inflation. The painful truth is that reducing inflation is costly. America paid a very high price—a deep and long recession—to bring inflation down from about 10 percent to about 4 percent in the early 1980's. But that price was necessary because double-digit inflation was intolerable. Then, after we overshot normal capacity and inflation crept back above 5 percent in 1989–1990, we suffered through another, albeit smaller, recession to bring it back down to its current level of below 3 percent. These costs were not abstract. Millions of Americans lost their jobs, some for long periods of time.

Having paid the price to achieve these gains on the inflation front, it would be sheer folly to squander them now. There is simply no good reason to push the economy beyond its normal capacity and into the inflationary zone; any job gains we enjoyed in the short run would be balanced by job losses later. If unemployment is to be pushed below the currently estimated natural rate, it must be done by structural policies—like education and training—not by monetary policy.

Third, short-run fluctuations in inflation depend on more than just monetary policy. Fiscal policy, through its effects on aggregate demand, can be either inflationary or disinflationary. Food prices and energy prices, which are largely beyond our control, can push inflation up or down for a while. Sometimes we are unlucky, as when OPEC struck in 1973–74 and 1979–80, and inflation shoots up. Sometimes we are lucky, and inflation declines, as in 1985–86 and again last year. If monetary policy is used to cut our losses on the inflation front when luck runs against us, and pocket the gains when good fortune runs our way, we can continue to chip away at the already-low inflation rate.

Fourth, and finally, there is wisdom in the old adage that where you stand depends on where you sit. The Federal Reserve is society's ultimate bulwark against inflation, and this stark fact gives every member of the Board a special responsibility that, for example, I never had as an outsider. It is the reason, I think, that Congress wisely gave the Fed so much political independence.

The intent of Congress was, pretty clearly, to ensure that the Fed would be able to take the long view and do what is best for the economy, passing up opportunities to reap short-run gains at the expense of the economy's long-run interests. If you take the long view, there are really no conflicts among the three goals that Congress gave the Fed: maximum employment, stable prices, and moderate long-term interest rates.

THE INDEPENDENCE OF THE FED

Given what I have just said, it will not surprise you that I strongly support the independence of the Fed. The main reason is simple: I think an independent central bank is best for the long-run economic welfare of the country.

But independence need not and should not mean arrogance, insensitivity, or lack of accountability. The Fed should not watch election returns or public opinion polls, but it should watch the well-being of the proverbial man and woman on the street. And it should always remember that it has 260 million clients. The American people do not want inflation, and they do want jobs. That's what Congress has asked the Fed to deliver, and that's what it should try to do. Yes, the Fed is judged every day by the financial markets. But these are fleeting evaluations. Its ultimate judge is the public—and history. In fact, I believe that the ultimate, long-run verdicts of the markets, the public, and the history books will all be the same.

Independence also need not and should not mean mystery. The minutia of central banking will always be mysterious to most people; nor do they much care. But the Fed's basic decisions about monetary policy affect almost everyone. And while the *process* of reaching them is best conducted in private, so that frank interchange is encouraged, the *decisions* themselves should be transparent. In this regard, I applaud the Fed's recent practice of announcing FOMC decisions explicitly and promptly rather than leaving markets guessing while professional Fed-watchers divine its intentions. It is a step I have long advocated, and I hope it will become a permanent part of the Fed's operating procedures. Indeed, I think the Fed can do a better job than it has to date of explaining its goals and policies to the American people.

Mr. Chairman and Members of the Committee, I thank you for listening and hope this statement has conveyed to you my basic views on monetary policy. I would now be happy to answer any questions you might have.

STATEMENT FOR COMPLETION BY PRESIDENTIAL NOMINEES

Name: BLINDER (LAST) · ALAN (FIRST) STUART (OTHER)

Position to which nominated: Vice Chairman, Board of Governors of ~~the Federal Reserve System~~ Date of nomination: April 22, 1994

Date of birth: 14 (DAY) 10 (MONTH) 45 (YEAR) Place of birth: Brooklyn, New York

Marital status: Married Full name of spouse: Madeline Donna Blinder (m.,Schwartz)

Name and ages of children: Scott Blinder, 21

William Blinder, 17

Education:

Institution	Dates attended	Degrees received	Dates of degrees
Massachusetts Institute of Technology	9/69 - 8/71	Ph.D.	8/71
London School of Economics & Political Science	9/67 - 7/68	M.Sc.	7/68
Princeton University	9/63 - 6/67	A.B.	6/67
Syosset High School	9/59 - 6/63	H.S.	6/63

Honors and awards: List below all scholarships, fellowships, honorary degrees, military medals, honorary socie memberships, and any other special recognitions for outstanding service or achievemer

Fellowships: Fulbright, London, 1967-1968
NDEA Graduate Fellowship, 1969-1971

Professional: Fellow, American Academy of Arts and Sciences, 1991-
Vice President, American Economic Association, 1989
Vice President, Eastern Economic Association, 1992-93
Richard T. Ely Lecturer, American Economic Associatio 12/87
W.S. Woytinsky Lecturer, Univ. of Michigan, 12/81
Fellow of the Econometric Society, 1981-
Visiting Scholar, Russell Sage Foundation, 1991-92
Visiting Scholar, Economic Planning Agency, Tokyo, Summer 1991
Visiting Fellow, Brookings Institution, 1985-86
Fellow, Institute for Advanced Studies, Hebrew Univ. of Jerusalem, 1976-77

Memberships: List below all memberships and offices held in professional, fraternal, business, scholarly, civic, charitable and other organizations.

Organization	Office held (if any)	Dates
(SEE ATTACHED C.V.)		

Employment record: List below all positions held since college, including the title or description of job, name of employment, location of work, and dates of inclusive employment.

Member, President's Council of Economic Advisers, 1/93 to Present.
Professor of Economics, Princeton University, 9/71 to Present
Self-employed as writer, public speaker, at home, 9/71 to 1/93
Visiting Scholar, Russell Sage Foundation, 9/91 to 8/92
Visiting Fellow, Brookings Institution, 9/85 to 6/86
Visiting Fellow, National Bureau of Economic Research, 9/80 to 6/81
Deputy Assistant Director, Congressional Budget Office, 5/75 to 9/75
Economics Instructor, Boston State College, 1969
Finance Instructor, Rider College, 1968 to 1969

Government experience: List any experience in or direct association with Federal, State, or local governments, including any advisory, consultative, honorary or other part-time service or positions.

Member, President's Council of Economic Advisers, 1/93 to Present

Deputy Assistant Director, Congressional Budget Office, 5/75 - 9/75

Also, see attached C.V. for a listing of Congressional committees I testified before.

Published writings: List the titles, publishers and dates of books, articles, reports or other published materials you have written.

SEE ATTACHED C.V. plus list of newspaper and magazine articles.

Political affiliations and activities: List all memberships and offices held in and services rendered to all political parties or election committees during the last 10 years.

I have been an advisor to the Clinton and Dukakis campaigns.

Political contributions: Itemize all political contributions of $500 or more to any individual, campaign organization, political party, political action committee or similar entity during the last eight years and identify the specific amounts, dates, and names of the recipients.

NONE.

Qualifications: State fully your qualifications to serve in the position to which you have been named. (attach sheet)

SEE ATTACHED QUALIFICATIONS STATEMENT

Future employment relationships:

1. Indicate whether you will sever all connections with your present employer, business firm, association or organization if you are confirmed by the Senate.

I am on official leave from Princeton University. Since joining the Council of Economic Advisers, I have severed all connections with other employers, associations, and organizations with which I had past contact other than purely honorific or professional associations.

2. As far as can be foreseen, state whether you have any plans after completing government service to resume employment, affiliation or practice with your previous employer, business firm, association or organization.

I expect to return to Princeton University.

3. Has anybody made you a commitment to a job after you leave government?

NO.

4. Do you expect to serve the full term for which you have been appointed?

YES.

ALAN S. BLINDER **SS#103-36-4906**

Attachment to Senate Banking Questionnaire

Qualifications, page 4:

While the Federal Reserve has many tasks, its principal responsibility is surely the conduct of monetary policy. Effective monetary management, in turn, is predicated on careful study and analysis of all aspects of the macroeconomy--a task to which the Fed, appropriately, devotes enormous staff resources. Most of my professional life has been devoted to precisely this subject: theoretical and empirical research on macroeconomics. At the time, I was not thinking of any of this as preparation for being Vice Chairman of the Federal Reserve Board. But, in retrospect, much of my career turns out to have been directly relevant to the job to which I have been nominated.

Several of my earliest research projects dealt with the measurement and evaluation of monetary policy ("New Measures of Monetary and Fiscal Policy, 1958-1973," American Economic Review, December 1976, pp. 780-796 (with Stephen M. Goldfeld), and "Implications of Endogenous Stabilization Policy," Brookings Papers on Economic Activity 3, 1972, pp. 585-640 (with Stephen M. Goldfeld)), and the subject has been a continuing interest of mine throughout my academic career--both as author and teacher. In fact, my most frequently-cited scholarly paper ("Does Fiscal Policy Matter?," Journal of Public Economics, November 1973, pp. 319-337 (with Robert M. Solow)) examines the interaction between budget deficits and monetary policy. Several of the last scholarly papers I published before joining the government related either directly ("The Federal Funds Rate and the Channels of Monetary Transmission," American Economic Review, Vol. 82, No. 4, September 1992, pp. 901-921 (with Ben Bernanke)) or indirectly ("On Sticky Prices: Academic Theories Meet the Real World," Monetary Policy, forthcoming, (edited by N. Greg Mankiw)) to the conduct of monetary policy. All together, I have written or coauthored 18 papers that were explicitly about monetary policy and another 37, plus several books, on related topics in macroeconomics.

Academic economists are often aloof from practical policy debates; but I have not been. For years I watched the Fed's behavior closely from the outside, wrote about it in newspapers and magazines, participated in Fed advisory groups, and testified about monetary policy before Congressional committees. Sometimes I was critical of the Fed's decisions, sometimes full of praise. But all of this Fed-watching has given me a deep appreciation of the subtleties and difficulties of conducting monetary policy. It is not an easy job, and I have learned from both the Fed's errors and its triumphs.

<u>Qualifications, page 4</u> (cont'd):

Since I joined the Council of Economic Advisers in January 1993, a large part of my job has been macroeconomic analysis and forecasting--which includes, among other things, study and analysis of the Fed's current and prospective policies. Much, if not all, of this work is directly relevant to what I will do if confirmed as Vice Chairman of the Federal Reserve Board. In addition, I have acquired a broad understanding of how a wide variety of economic policies are made.

Potential conflicts of interest:

1. Describe any financial arrangements or deferred compensation agreements or other continuing dealings with business associates, clients or customers who will be affected by policies which you will influence in the position to which you have been nominated.

NONE.

2. List any investments, obligations, liabilities, or other relationships which might involve potential conflicts of interest with the position to which you have been nominated.

I own some U.S. Government securities, which I will divest before being sworn in.

3. Describe any business relationship, dealing or financial transaction (other than taxpaying) which you have had during the last 10 years with the Federal Government, whether for yourself, on behalf of a client, or acting as an agent, that might in any way constitute or result in a possible conflict of interest with the position to which you have been nominated.

NONE.

4. List any lobbying activity during the past 10 years in which you have engaged for the purpose of directly or indirectly influencing the passage, defeat or modification of any legislation at the national level of government or affecting the administration and execution of national law or public policy.

NONE.

5. Explain how you will resolve any potential conflict of interest that may be disclosed by your responses to the above items.

I will divest myself of any assets for which I am asked to do so.

Civil, criminal and investigatory actions:

1. Give the full details of any civil or criminal proceeding in which you were a defendant or any inquiry or investigation by a Federal, State, or local agency in which you were the subject of the inquiry or investigation.

NONE

2. Give the full details of any proceeding, inquiry or investigation by any professional association including any bar association in which you were the subject of the proceeding, inquiry or investigation.

NONE.

CURRICULUM VITAE

Alan Stuart Blinder

April 1994

Address

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Rm. 314, OEOB
Washington, DC 20500
(202) 395–5046
FAX:(202) 395–6958

Personal Data

Born: October 14, 1945, Brooklyn, New York.
Marital Status: Married; two sons, ages 21 and 17.

Educational Background

Ph.D., Massachusetts Institute of Technology, 1971.
M.Sc. (Econ.), London School of Economics, 1968.
A.B., Princeton University, summa cum laude in economics, 1967.

Professional Activities, Honors, etc.

Member, President's Council of Economic Advisers, 1993–.
Fellow, American Academy of Arts and Sciences, 1991–.
Vice-President, American Economic Association, 1989.
  Executive Committee, 1985–87.
  Commission on Graduate Education, 1988–90.
  Committee on Honors and Awards, 1988–93.
Vice President, Eastern Economic Association, 1992–93.
Member, Academic Advisory Panel, Federal Reserve Bank of New York, 1990–93.
Member, Research Advisory Board, Committee for Economic Development, 1992–93.
Member, Selection Committee, Frank E. Seidman Distinguished Award in Political Economy, 1991 and 1992.
International Associate Member, Foundation for Advanced Information and Research, Japan, 1989–93.
Member, Board of Directors, Social Science Research Council, 1987–90.
  Executive Committee, 1988–90.
Member, Advisory Committee on Economics, Alfred P. Sloan Foundation, 1984–93.
Member, NSF Economics Panel, 1985–86.
Chairman, Economic Policy Committee, National Policy Exchange, 1981–85.
Member, Conference on Research in Income and Wealth (NBER), 1988–93.
Member, National Academy of Social Insurance, 1988–94.
Member of Advisory Board, Penman Asset Management, 1992–93.
Member, Board of Editors, *Journal of Economic Literature,* 1981–84, 1988–93.
Member, Editorial Board, *Journal of Monetary Economics,* 1981–93.
Associate Editor, *Journal of Public Economics, 1982–93.*
Member, Editorial Board, *Challenge,* 1984–93.
Member, Board of Editors, *The American Prospect,* 1989–93.
Joseph L. Lucia Lecturer, Villanova University, October 1992.
Kane Lecturer, Bentley College, November 1991.
Distinguished Speaker, Eastern Economic Association, March 1990.
H. Chase Stone Lecturer, Colorado College, January 1990.
Tennenbaum Lecturer, Georgia Institute of Technology, Nov. 1989.
Henry George Lecturer, University of Scranton, October 1988.
Richard T. Ely Lecturer, American Economic Association, December 1987.
David Kinley Lecturer, University of Illinois, October 1986.
Kathleen Bryan Lecturer, University of North Carolina, Greensboro, March 1986.
W.S. Woytinsky Lecturer, University of Michigan, December 1981.
Director, Center for Economic Policy Studies, Princeton University, 1989–93.
Bicentennial Preceptor, Princeton University, 1975–78.
Fellow of the Econometric Society, 1981–.
Member, Brookings Panel on Economic Activity, 1981 and 1985; Senior Adviser, 1982–93.
Research Associate, National Bureau of Economic Research, 1978–93.
Member, American Economic Association.
Member, International Society for Inventory Research.
Economics columnist, *Business Week,* 1985–92.
Economics columnist, *The Boston Globe,* 1981–85.

Occasional columnist, *Washington Post,* 1982–90.
Occasional columnist, *Newsday,* 1987–92.
Editorial advisor, Bristlecone Books, 1990–92.
Deputy Assistant Director, Fiscal Analysis Division, Congressional Budget Office, Washington, DC, 1975.
Consultant, Congressional Budget Office, 1975–92.

TEACHING EXPERIENCE

Gordon S. Rentschler Memorial Professor of Economics, Princeton Univ., 1982–.
Chairman, Department of Economics, Princeton University, 1988–90.
Professor of Economics, Princeton University, 1979–82.
Associate Professor of Economics, Princeton University, 1976–79.
Assistant Professor of Economics, Princeton University, 1971–76.
Instructor in Economics, Boston State College, Boston, MA, 1969.
Instructor in Finance, Rider College, Trenton, NJ, 1968–69.

VISITING APPOINTMENTS

Visiting Scholar, Russell Sage Foundation, 1991–92.
Visiting Scholar, Economic Planning Agency, Tokyo, Summer 1991.
Visiting Fellow, The Brookings Institution, 1985–86.
Bryan Visiting Professor, University of North Carolina at Greensboro, March 1986.
Visiting Professor, Institute for International Economic Studies, Stockholm, Summer 1983.
Visiting Professor, Institute for Advanced Studies, Vienna, Summer 1982.
Fellow, Institute for Advanced Studies, Hebrew University of Jerusalem, 1976–77.
Visiting Assistant Professor, Stanford University, 1974.

AREAS OF SPECIAL INTEREST

Stabilization policy, macroeconomics, income distribution, the Japanese economy.

PUBLICATIONS

Books

Growing Together: An Alternative Economic Strategy for the 1990's, Whittle, 1991.
Paying for Productivity, Brookings, 1990 (edited volume).
Macroeconomics Under Debate, Harvester-Wheatsheaf, 1989.
Inventory Theory and Consumer Behavior, Harvester-Wheatsheaf, 1989.
Economic Opinion, Harcourt Brace Jovanovich, First edition 1989; Second edition 1991.
Hard Heads, Soft Hearts: Tough-Minded Economics for a Just Society, Addison-Wesley, 1987; paperback edition: 1988; Japanese translation: 1988.
Economics: Principles and Policy, Harcourt Brace Jovanovich, First edition 1979; Second edition 1982; Third edition 1985; Fourth edition 1988; Fifth edition 1991, and Sixth edition 1994 (with William J. Baumol); also Canadian, Australian, and Japanese editions.
Private Pensions and Public Pensions: Theory and Fact, The University of Michigan, 1983.
Economic Policy and the Great Stagflation, Academic Press, 1979, 229 pp. (paperback edition: 1981; Japanese edition: 1982).
Natural Resources Uncertainty and General Equilibrium Systems: Essays in Memory of Rafael Lusky, Academic Press, 1977 (co-edited with Philip Friedman).
Toward an Economic Theory of Income Distribution, The MIT Press, 1974, 176 pp. (paperback edition: 1977).

Articles

Forthcoming

"On Sticky Prices: Academic Theories Meet the Real World," *Monetary Policy,* University of Chicago Press, edited by N. Gregory Mankiw.
"Should the Former Socialist Economies Look East or West for a Model?," International Economic Association, *Moscow Congress Proceedings,* forthcoming.
"International Differences in Labor Turnover: A Comparative Study with Emphasis on the U.S. and Japan," (with Alan Krueger).

1993

"Free Trade," in D. Henderson (ed.), *Fortune Encyclopedia of Economics,* pp. 526–529, 1993.

"Keynesian Economics," in D. Henderson (ed.), Fortune Encyclopedia of Economics, 1993, pp. 118–123.

1992

"More Like Them?," *American Prospect,* Winter 1992.
"Growing Together," *Princeton Alumni Weekly,* March 4, 1992.
"International Perspective: Trading with Japan: Why the U.S. Loses—Even on a Level Playing Field," *Business Economics,* Vol. 27, No. 1, January 1992.
"The Federal Funds Rate and the Channels of Monetary Transmission" (with Ben Bernanke), *American Economic Review,* Vol. 82, No. 4, September 1992, pp. 901–921.
"Consumer Durables: Evidence on the Optimality of Usually Doing Nothing," *Journal of Money, Credit, and Banking,* Vol. 24, No. 2 (May 1992), pp. 258–272 (with Avner Bar-Ilan).

1991

"The Resurgence of Inventory Research: What Have We Learned?," *Journal of Economic Surveys,* Vol. 5, No. 4 (1991) (with Louis J. Maccini).
"Report of the Commission on Graduate Education in Economics," *Journal of Economic Literature,* Vol. 29 (September 1991), pp. 1035–1053 (with other members of the Commission).
"Profit Maximization and International Competition," Forthcoming in Richard O'Brien (ed.), *Finance and the International Economy: 5—The AMEX Bank Review Prize Essays,* Oxford University Press, 1991.
"Is the National Debt Really—I Mean, *Really*—A Burden?" in *Debt and the Twin Deficits Debate,* edited by James Rock, Mayfield Publishing Company, 1991.
"Why Are Prices Sticky? Preliminary Results from an Interview Study," *American Economic Review,* May 1991, pp. 89–96.
"The Supply of and Demand for Macroeconomic Advice" (printed in Finnish as "Talouspoliittinen neuvonanto—kysyntä ja tarjonta"), *Finnish Economic Journal,* Vol. 87, January 1991, pp. 80–90.
"Taking Stock: A Critical Assessment of Recent Research on Inventories," *Journal of Economic Perspectives,* Winter 1991, pp. 73–96 (with Louis J. Maccini).

1990

"A Shred of Evidence on Theories of Wage Stickiness," *Quarterly Journal of Economics,* Vol. 55, Issue 4, November 1990 (with Don H. Choi), pp. 1003–1015.
"Learning By Asking Those Who Are Doing," *Eastern Economic Journal,* Vol. 16, No. 4, October/December 1990, pp. 297–306.
"Economic Policy and Economic Science: The Case of Macroeconomics," in *Perspective 2000,* edited by K. Newton, T. Schweitzer, and J.-P Voyer, Economic Council of Canada, 1990.
"A Report on the Evidence: Pay, Participation, and Productivity," *The Brookings Review,* Winter 1989/90.

1989

"In Honor of Robert M. Solow: Nobel Laureate in 1987," *Journal of Economic Perspectives,* Vol. 3, No. 3, Summer 1989.
"The Monetary-Fiscal Transition in the United States," Institute of Fiscal and Monetary Policy, *Financial Review* (Tokyo), May 1989 (published in Japanese translation).
"The Stylized Facts About Credit Aggregates," in *Macroeconomics Under Debate,* Harvester-Wheatsheaf, 1989.
"The Comparative Statics of a Credit-Rationing Bank," in *Macroeconomics Under Debate,* Harvester-Wheatsheaf, 1989.

1988

"The Fall and Rise of Keynesian Economics," *The Economic Record,* December 1988. Reprinted in—P. Maxwell (ed.), *Macroeconomics: Contemporary Australian Readings,* Harper & Row, 1991.
"The Challenge of High Unemployment," *American Economic Review,* Vol. 78, No. 2, May 1988.
"Credit, Money, and Aggregate Demand," *American Economic Review Papers and Proceedings,* Vol. 78, No. 2, May 1988 (with Ben S. Bernanke).

"The Life-Cycle Permanent-Income Model and Consumer Durables," *Annales d'Economie et de Statistique,* January–March 1988 (with Avner Bar-Ilan).

"Why Is the Government in the Pension Business?," in Susan Wachter (ed.), *Providing for Retirement in the Twenty-First Century,* D.C. Heath, 1988.

"The Rules-versus-Discretion Debate in the Light of Recent Experience," *Weltwirtschaftliches Archiv,* Sept. 1987 (reprinted in H. Giersch (ed.), *Macro and Micro Policies for More Growth and Employment,* J.C.B. Mohr, 1988, pp. 45–63).

1987

"Credit Rationing and Effective Supply Failures," *Economic Journal,* June 1987, pp. 327–352.

"Keynes, Lucas, and Scientific Progress," *American Economic Review,* May 1987, pp. 130–136 (reprinted in *John Maynard Keynes (1883–1946), Volume II,* edited by Mark Blaug (Edgar Elger Publishing Co.), 1991, pp. 188–194).

"Credit Rationing and Aggregate Supply in Economies with Less-Developed Financial Systems," *Conference on Economic Development and Social Welfare in Taiwan,* Volume I, Institute of Economics, Academia Sinica, Taipei, Taiwan, January 6–7, 1987, pp. 41–53.

1986

"Keynes After Lucas," *Eastern Economic Journal,* July–Sept. 1986, pp. 209–216.

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"Fun With M1 and M2," August 10, 1983.
"Add Another Murphy's Law," June 3, 1983.
"Reagan's Right About A Tax Hike Now, But How Do We Cut Those Deficits?," May 16, 1983.
"Good News for All But the Sheiks," February 18, 1983.
"Taxing Unemployment Benefits Is A Good Idea," December 15, 1982.
"Raising Keynes," October 25, 1982.
"An Extravagant Relative's Bequest," August 9, 1982.
"Capital Gains: Tax Them Like Income," July 2, 1982.
"A Proposal for Supply-Side Economics That Doesn't Squeeze Out the Poor," June 15, 1982.

"Searching for A Way Out of the Pitfalls of Reaganomics," March 2, 1982.
"Economists, Just Look Out the Window," August 14, 1981.

L.A. TIMES

"Tax Plan: So Many Stand to Gain," May 12, 1986.

NEWSDAY

"Venture Capital Can Buy National Security," February 7, 1990.
"Bush's Savings Plan: A Drop in Our Buckets," October 6, 1988.
"A Deficit Debate Candidates Don't Want to Join," March 15, 1988.
"Understanding the Stock Market Enigma," December 12, 1987.
"Save the Environment: Issue Pollution Permits," August 18, 1987.
"For Smarter Protectionism," March 6, 1987.

SAN DIEGO UNION-TRIBUNE

"Rebuild from Bottom Up by Investing," November 1, 1992.

STATEMENT OF STEVEN M.H. WALLMAN

CONCERNING HIS NOMINATION TO BE COMMISSIONER OF THE SECURITIES AND EXCHANGE COMMISSION

Mr. Chairman and Members of the Committee: It is with great pleasure that I appear before you today. I am honored to have been nominated by President Clinton to serve as a Commissioner of the Securities and Exchange Commission.

I would first like to introduce you to my wife, Kathy, who recently had the privilege of entering Government service as the Deputy Chief of the Cable Services Bureau of the Federal Communications Commission. Her love, friendship, advice, and encouragement have been an inspiration for me. Also here is my mother, Doris, who has instilled in me confidence, tempered with the desire to do the right thing.

I would like to thank you Mr. Chairman, the other Members of the Committee and the Committee's staff, many of whom I have worked with in the past, for your consideration of my nomination.

My first recollection of the Commission dates back to when I was about six. I remember my father talking to me outside of a subway station in Manhattan near the apartment where we lived. He was talking about what he did—he was a lawyer, practicing alone, predominantly handling securities and corporate matters. He had some issue before the Commission, and he was talking about how tough the agency was, and how dogged in the pursuit of its mission. And, when like 6-year olds sometimes do, I said something to show my dad that I was on his side, he told me how fair and right the Commission was, and how terrific a job they were doing. That started me down the road of understanding how good a Federal agency can be, a road that has led me to share the tremendous respect that people throughout the world feel for the Commission. If my father were alive today, I know he would be very pleased about my nomination.

The Commission's unswerving determination to protect investors has contributed to the creation of the largest, most efficient, and most envied capital markets in the world. By ensuring the integrity of those markets, entrepreneurs find capital at reasonable cost, investors retire wealthier and companies produce products, provide jobs and improve the standard of living. In a capitalist system, protecting investors and preserving market integrity increases the incentives for investment, decreases the cost of capital, and enhances the potential of society to do better for *all* of its citizens, even those who may currently lack the wherewithal to invest.

For the past decade and a half I have practiced law as a corporate and securities attorney fascinated by the evolving potential of our system to improve our lives. As a Commissioner, I would work to promote that potential and to try to continue to convert it into reality. I would do so here with the advantage of having the exceptional leadership of Chairman Levitt and Commissioners Schapiro, Roberts, and Beese.

The challenges facing the Commission and the markets at any one time vary with changes in the world. Currently, new communications technologies, computer capabilities and quantitative methods allow for the creation of new instruments that can be traded globally and promise higher returns at lower risks. They may not always work as intended, but mostly they do. With new products come new issuers providing additional choices to investors and services to end users while blurring, and sometimes erasing, the traditional lines that compartmentalize the financial sector. If confirmed as a Commissioner, I would hope to work closely with the banking regulators and the CFTC on such matters, which are of interest to all of us.

Entrepreneurs raise money on the basis of a dream and a promise. And when stock prices do not always follow the expected path, investors, justifiably, want to know why. Distinguishing between fraud and mere changes in circumstances is not always easy. But we must try harder, lest we encourage frauds and taint our markets on the one hand, or stifle innovation and information and capital flows on the other. With an open mind, if confirmed I would make it a priority to learn more about these issues and work with this Committee as it wrestles with a difficult task.

We must work to ensure that emerging democracies have the benefit of our capital markets' experience and the advantages of the expertise of our capital markets participants. There are no examples of major, sustained democracies without capital markets participation. I believe the two are inextricably linked. If confirmed, I look forward to working with those around the world who share a similar view.

Our markets our very efficient and very transparent, and they consistently improve. If confirmed, I would like to devote attention to lowering further the cost of capital and ensuring better capital availability for all our companies, small as well as large, to help them compete and grow, and to help them produce products and provide services that benefit us all.

At heart, it is the promise of what Main Street can do for Wall Street, and what Wall Street can do for Main Street, that is so alluring to me, and what makes the opportunity to work at the Commission such an honor.

Mr. Chairman, if confirmed by the Senate, I look forward to working with you, your colleagues on the Committee and the Committee staff. I will be honored to have an opportunity to be a part of a team that protects investors, preserves and enhances the integrity and efficiency of our markets, facilitates capital formation, strengthens industry, and thereby improves our society and betters our world.

Thank you, and I would be pleased to answer any questions you may have.

STATEMENT FOR COMPLETION BY PRESIDENTIAL NOMINEES

Name: Wallman (LAST) Steven (FIRST) Mark Harte (OTHER)

Position to which nominated: Commissioner, Securities and Exchange Commission Date of Nomination: 4-13-94

Date of birth: 14 11 53 (Day) (Month) (Year) Place of birth: New York, New York

Marital status: Married Full name of spouse: Kathleen Mary Harte Wallman

Name and ages of children: None

Education:

Institution	Dates Attended	Degrees Received	Dates of Degrees
Horace Mann High School	1965-1971	High School Diploma	1971
Massachusetts Institute of Technology	1971-1975	S.B. S.M.	June 1975 September 1976
Columbia University School of Law	1975-1976 1977-1978	J.D.	May 1978
Harvard University School of Law	1976-1977	None	

Honors and awards: List below all scholarships, fellowships, honorary degrees, military medals, honorary society memberships, and any other specific recognitions for outstanding service or achievement.

Admitted to membership in the American Law Institute.

Harlan Fiske Stone Scholar (Columbia University School of Law).

Memberships: List below all memberships and offices held in professional, fraternal, business, scholarly, civic, charitable and other organizations.

Organization	Office Held (if any)	Dates
American Law Institute	Member	12/6/90-Present
American Bar Association	Member	2/14/91-Present
MIT Alumni Association	Member	6/75-Present
District of Columbia Bar Association	Member	12/15/78-Present
Virginia Bar Association	Member	4/21/86-Present
Women's Legal Defense Fund	Member	12/31/93-Present

Employment record: List below all positions held since college, including the title or description of job, name of employment, location of work, and dates of inclusive employment.

1. Coffee house manager and assorted other student center related activities at MIT during summers 1975 and 1976.

2. Summer Associate (intern), Rogers & Wells (D.C. and New York) Summer 1977 and part-time during 1977-78.

3. Associate, Boston Consulting Group (Menlo Park, California), Fall, 1978.

4. Associate (1978-1986), Partner (1986-present), Covington & Burling (D.C.).

Government experience: List any experience in or direct association with Federal, State, or local governments, including any advisory, consultative, honorary or other part-time service or positions.

None

Published writings: List the titles, publishers and dates of books, articles, reports or other published materials you have written.

Writings: "Independent Directors: Answer to Better Boards?" 28 Directorship 12, 5 (1993); "The Proper Interpretation of Corporate Constituency Statutes and Formulation of Director Duties," 21 Stetson Law Review 1, 163 (1991); "Corporate Constituency Concepts: Rationales & Benefits" paper delivered at the 1990 Virginia Bar Association Summer Meeting in Hot Springs, Virginia; "The Reemergence of the Corporate Constituency Concept" paper delivered at the American Bar Association Annual Meeting in Chicago, Illinois in August, 1990; "Pennsylvania's Anti-Raider Legislation" in Insights (August, 1990, Vol. 4, No. 8; "Corporate Constituency Statutes: Placing the Corporation's Interests First" appearing in The Business Lawyer Update (Nov/Dec, 1990) Vol. 11, No. 2; and "Commentary" on ALI Corporate Governance Project Section 6.02 in BNA's Corporate Counsel Weekly (August 7, 1991) Vol. 6, No. 32; "State Takeover Laws Work Well" in Legal Times, September 21, 1987 at 22 and in Manhattan Lawyer, October 13, 1987 at 35; "Response" in Debate in Harvard Business Review, July/August 1992 at 138; (high school and college student publications have been omitted).

Political affiliations and activities: List all memberships and offices held in and services rendered to all political parties or election committees during the last 10 years.

Legal services rendered to the Democratic National Committee through Covington & Burling from January 14, 1992 to January 15, 1993.

Member - Democratic Party.

Political contributions: Itemize all political contributions of $500 or more to any individual, campaign organization, political party, political action committee or similar entity during the last eight years and identify the specific amounts, dates, and names of the recipients.

None, except in 1992 as follows:

1) $300 on June 1, 1992 and $500 on October 28, 1992 to Barbara Boxer for U.S. Senate, candidate committee for Senator Barbara Boxer (D-CA).

2) $500 on September 30, 1992 to Pennsylvanians for Kanjorski, candidate committee for Representative Paul Kanjorski (D-PA).

3) $500 on September 30, 1992 to Andrews for Congress Committee, candidate committee for Representative Rob Andrews (D-NJ).

Qualifications: State fully your qualifications to serve in the position to which you have been named. (attach sheet)

See Attachment A.

Future employment relationships: 1. Indicate whether you will sever all connections with your present employer, business firm, association or organization if you are confirmed by the Senate.

See Attachment B.

2. As far as can be foreseen, state whether you have any plans after completing government service to resume employment, affiliation or practice with your previous employer, business firm, association or organization.

See Attachment C.

3. Has anybody made you a commitment to a job after you leave government?

No.

4. Do you expect to serve the full term for which you have been appointed?

Yes.

Potential conflicts of interest:

1. Describe any financial arrangements or deferred compensation agreements or other continuing dealings with business associates, clients or customers who will be affected by policies which you will influence in the position to which you have been nominated.

None.

2. List any investments, obligations, liabilities, or other relationships which might involve potential conflicts of interest with the position to which you have been nominated.

See Attachment D.

3. Describe any business relationship, dealing or financial transaction (other than tax paying) which you have had during the last 10 years with the Federal Government, whether for your self, on behalf of a client, or acting as an agent, that might in any way constitute or result in a possible conflict of interest with the position to which you have been nominated.

None (see Attachment E).

4. List any lobbying activity during the past 10 years in which you have engaged for the purpose of directly or indirectly influencing the passage, defeat or modification of any legislation at the national level of government or affecting the administration and execution of national law or public policy.

Attachment E.

5. Explain how you will resolve any potential conflict of interest that may be disclosed by your responses to the above items.

Attachment F.

Civil, criminal and investigatory actions:

1. Give the full details of any civil or criminal proceeding in which you were a defendant or any inquiry or investigation by a Federal, State, or local agency in which you were the subject of the inquiry or investigation.

None.

2. Give the full details of any proceeding, inquiry or investigation by any professional association including any bar association in which you were the subject of the proceeding, inquiry or investigation.

None.

Attachment A

I have been a corporate and securities lawyer at Covington & Burling for over 15 years. Before that I worked for a few months for the Boston Consulting Group, a leading management consulting firm. My educational background includes degrees from both law school and graduate business school.

In addition to a transactional and securities law practice for Covington & Burling's corporate clients, I have also been involved in securities and corporate law policy matters. During 1987 and 1988, I represented a coalition and certain companies with respect to Federal lobbying activities in favor of legislation introduced by Senators Proxmire, Sasser, and Sanford. In addition, I was involved in State legislation that served to reaffirm the obligation of corporate directors to act in the best interests of the corporation, that permitted minority shareholders to obtain a fair value for their shares in the event of a change of control, and that permitted the corporation to recover, for the benefit of all its shareholders, profits from short-term trading engaged in by persons trying to put a corporation "in play."

In connection with these activities, I have worked closely with various groups, including business groups such as the Business Roundtable (the Corporate Governance Task Force of which has recently been a client of Covington & Burling (from June 18, 1993 to February 16, 1994)) and the National Association of Manufacturers, and other groups such as the National Governors Association and the National Conference of State Legislators. I have also developed relationships with labor organizations, and the Pennsylvania AFL-CIO was a primary proponent of the State legislation mentioned above. In addition, I have spoken and lectured numerous times on corporate and securities law and policy issues before professional groups and have written a number of short articles and a few longer pieces on these and related topics.

More recently, as change of control issues have become less of a factor in corporate and securities law policy, I have been working closely with business, shareholder and labor groups monitoring and reviewing issues of common concern to these groups.

As a lawyer in private practice, I have been in a position to observe the effects of regulation on the activities of those who are regulated and to understand the need to weigh the costs as well as the benefits of regulation. I am deeply committed to protecting and enhancing the interests of the investing public and to promoting the ability of American businesses to create jobs and to enhance the standard of living within our market structure.

Attachment B

I am presently a partner in the law firm of Covington & Burling. I certify that I will resign from this position prior to taking the oath as Commissioner, and will sever all other ties with Covington & Burling upon confirmation of my appointment to the Commission. Upon confirmation of my appointment to the Commission, my interest in the Covington & Burling pension plan will be terminated. I intend to roll over my holdings in the pension plan into another qualified retirement plan separate from Covington & Burling. Coverage provided under the life and accidental dismemberment and disability plans offered by Covington & Burling shall automatically terminate not later than 2 months after my resignation from the partnership. For purposes of compliance with my ethics agreement, except as otherwise noted, such undertakings shall occur upon confirmation of my appointment or, consistent with OGE regulations, within 3 months of my Senate confirmation, unless an extension is approved by OGE.

Pursuant to my understanding with Covington & Burling and consistent with Covington & Burling's partnership agreement and policy, I will receive a severance/termination payout from Covington & Burling. I will receive full payout of this severance amount in one lump sum upon confirmation of my appointment to the Commission. The amount of the payment will be equal to the average of the 5 highest years' partnership draw, discounted at the borrowing rate for Covington & Burling over a 3 year period. In addition, I will be paid a prorated portion of my annual partnership distribution in connection with services rendered and allocated through the date of my termination from the Covington & Burling partnership. This amount will be paid upon confirmation of my appointment to the Commission. My partnership capital will also be returned to me upon my termination from the partnership, which such amount will also be paid upon confirmation of my appointment to the Commission. These amounts will be fixed upon my withdrawal from Covington & Burling and are not contingent on any future services that I will provide to the firm, nor are they tied to the future financial fortunes of the firm.

ATTACHMENT C

After completing Government service, I expect to return to private sector employment. I have no offer of future employment from Covington & Burling or any other entity, nor have I committed myself to return to employment with Covington & Burling or to join any other entity.

ATTACHMENT D

CLIENTS

Aegis Research Corporation
Chesapeake Utilities Corporation
Democratic National Committee
Duke University
Galileo International
Gillette Company
Imperial Holly Corporation
JLG Industries Inc.
Lynagh and Dahlman
National Football League
Scott Paper Company
The Business Roundtable
The Cellular Income Fund
The Hampton Mercantile Corporation
World League of American Football

* * * * *

LAW FIRM

Covington & Burling

FINANCIAL INTERESTS

Charles Schwab & Co., Inc.
Dean Witter Reynolds, Inc.
Fidelity Investments, Inc.
AIM
Investment Company of America (Capital Research Management, Inc.)
Vista
Vanguard
Oppenheimer & Co., Inc.
Dominion Resources, Inc.
Water-Jel Technology, Inc.
NationsBank, Inc.
Metropolitan Life Insurance Co.
Hartford Life Insurance Co.
Imsatt Corporation
Savings Bank Life Insurance Co.
Connecticut Mutual Life Insurance Co.
Loyola Federal Savings

ATTACHMENT E

As noted elsewhere in this questionnaire, in 1987 and 1988, I represented, through Covington & Burling, a Coalition (now-dissolved) and certain companies (International Paper Company, Georgia-Pacific Corporation and Scott Paper Company) that favored legislation introduced by Senator Proxmire (S. 1323) and Senators Sasser and Sanford (S. 1324). More recently, from June 18, 1983 until February 16, 1984, I represented, through Covington & Burling, the Corporate Governance Task Force of the Business Roundtable with respect to Federal securities matters, with limited lobbying activities occurring in the fall of 1993. Most of this work consisted of monitoring, review and analysis (with respect to stock option accounting and, to a far lesser extent, the commencement of monitoring, review and analysis with respect to securities litigation) and no position was taken, in connection with my activities, with respect to any proposed legislation. (Not described are other representations engaged in by Covington & Burling for which I had no substantial involvement.) The ethics arrangements which I will undertake to resolve any appearance of a conflict of interest presented by these and other representations are described in the other attachments to this questionnaire, and in my ethics agreement, a copy of which I understand will be furnished to the Committee.

ATTACHMENT F

I have been furnished with a copy of 18 U.S.C. § 208, as amended by the Ethics Reform Act of 1989, and the Canons of Ethics for Members of the Securities and Exchange Commission, 17 C.F.R. § 200.50 *et seq.*, both of which I have read. I understand that, as required by 18 U.S.C. 208, I must recuse myself from participating personally and substantially in any particular matter in which, to my knowledge, I or anyone whose interest is imputed to me would have a financial interest, unless a written waiver is issued pursuant to 18 U.S.C. 208(b).[1] Alternatively, I will consider divesting any financial interest that presents a conflict of interest.

I also intend to disqualify myself for a period of 1 year from participation in any particular matter involving specific parties in which Covington & Burling or any of my clients listed on Attachment D is or represents a party, unless authorized to proceed pursuant to Subpart E of the Standards of Ethical Conduct for Employees of the Executive Branch, 5 C.F.R. 2635.502(c).

Notwithstanding the foregoing, I intend to participate in matters of general applicability. Such matters may include general policy considerations, rulemaking proceedings, and legislation, including matters that may involve Covington & Burling or my former clients. Of course, as required by 18 U.S.C. 208, I will not participate in any particular matter in which, to my knowledge, I or anyone whose interests are imputed to me, has a financial interest, if the particular matter would have a direct and predictable effect on that interest, unless a written waiver is issued pursuant to 18 U.S.C. 208(b).

Finally, I intend to disqualify myself on a case-by-case basis, with respect to any other matter where, in order to avoid the possible appearance of impropriety, it appears desirable to me to disqualify myself, despite the lack of any actual conflict of interest or any requirement to do so.

STATEMENT OF PHILIP N. DIEHL

NOMINEE FOR THE POSITION OF DIRECTOR OF THE UNITED STATES MINT

Mr. Chairman, Senator D'Amato, it's an honor to come before the Senate Committee on Banking, Housing, and Urban Affairs as President Clinton's nominee to be Director of the United States Mint.

As you know, the U.S. Mint is one of our Nation's oldest Federal agencies, with a history dating back 202 years. Unlike the Treasury Department, of which the Mint is a part, the U.S. Mint traces its origins to Thomas Jefferson rather than his great political and ideological rival, Alexander Hamilton. Among his many other interests, Jefferson was a coin collector and had strong opinions regarding the type of coinage system the Nation would need to ensure the convenient and efficient flow of goods and services within its borders. Out of his commitment to economic growth and equity, Jefferson authored, and advocated to eventual adoption by the Congress, the decimal coinage system we use today. He also founded the United States Mint during his tenure as the Nation's first Secretary of State.

Today, the U.S. Mint has grown into a billion-dollar-a-year international manufacturing and marketing enterprise with 2,200 employees, the largest coin-production operation in the world. If the Mint were a private sector concern, it would be counted among the Fortune 500.

In 1993, the Mint produced over 14 billion circulating coins valued at more than $500 million and generating over $300 million in seigniorage profits to finance the Federal debt, making the Mint one of the few Federal agencies to generate a profit. Faster economic growth in 1994 will boost coin demand by 25 percent, to some 18 billion coins.

In 1993, the Mint also produced and sold some 40 million coins in bullion and numismatic markets around the world, generating another $40 million in profits for the Federal treasury and $20 million in surcharges for sponsoring organizations authorized by Congress to receive these funds. All tolled, Mint commemorative programs over the past decade have raised $250 million for sponsoring organizations, providing funding for the training of Olympic athletes, the restoration of the Statue of Liberty and the Statue of Freedom on the Capitol dome, fellowships for study and teaching related to the U.S. Constitution, and to complete the circle in 1994, an endowment to preserve Monticello, the home of Thomas Jefferson.

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[1] I understand that the financial interests that would be imputed to me are those of a spouse, dependent child, general partner, or any organization in which I am serving as officer, director, or trustee, or any person with whom I am negotiating for employment.

These commemorative programs and the gold and silver bullion American Eagle programs play important roles in supporting demand in the U.S. gold, silver, and copper mining industries, providing jobs for American miners and coin strip manufacturers, and allowing for controlled disposal of excess supplies from the Federal stockpile of silver. In the process of making these contributions to the U.S. economy, the U.S. Mint has built the American Eagle into the most successful bullion coin program in the world, with the silver Eagle taking 70 to 80 percent of the world market and registering total sales of over 55 million one-ounce silver dollars. Likewise, the gold Eagle, after competing in world bullion markets for only 7 years, is now the world market share leader, with total sales of over 6 million ounces of gold.

If I am confirmed by the Senate as Director of the United States Mint, I intend to pursue three priorities during my term. First, the Mint is one of three Treasury bureaus that has not received a clean (i.e., unqualified) audit from its outside auditors under the Chief Financial Officers Act. My first priority will be to implement an aggressive schedule of financial management improvements that will lay the foundation for the Mint to receive a clean audit within 2 years. In fact, we have already begun this effort in the past 6 months, and I can report that good progress has been made, with the Mint obtaining an unqualified opinion on its manufacturing balance sheets.

Second, the Mint shares a challenge with this Committee on which I hope we can make progress in the near future: The continuing proliferation of commemorative coin programs. As the Congress recognized in 1992 when establishing the Citizens Commemorative Coin Advisory Committee and again in a Sense of the Congress Resolution passed in 1993, the Congress is authorizing the production of a rapidly increasing number of coin programs into a shrinking market for commemorative coins. This proliferation of coin programs is testing the limits of both collectors' willingness to buy and the Mint's ability to produce and market in a business-like fashion. Last November, Secretary Bentsen appointed the members of the Citizens Advisory Committee, which was created by Congress to provide advice on how to limit the number of commemorative programs. This committee will produce a report before the end of 1994 recommending a 5-year plan of commemorations and suggesting additional actions which might be considered to address this matter.

Third, there are opportunities on several fronts for the Mint to increase its profitability and thereby make a larger contribution to financing the Federal debt and increasing employment among the Mint's private sector suppliers. One opportunity is through the acquisition of more modern communications and production technology and the adoption of modern personnel management practices. I am persuaded that, in this regard, the Mint is especially ripe for "reinvention," with a significant potential for productivity improvements and savings.

I believe there are also opportunities, over the mid-term, to expand coin collecting into geographic and demographic markets that have in the past shown little interest in numismatics. One reason that commemorative coin sales have declined over the past decade is that the Mint has invested little in expanding its markets beyond the white males over 50 years of age who dominate our base of customers. We must develop marketing strategies that expand the appeal of coin collecting into younger and more ethnically diverse markets in order to respond to the rising demands in Congress for authorization of commemorative programs.

Finally, the Mint must secure the loyalty of its long-time customer base as well as its new customers by rapidly improving customer service, enhancing the artistic appeal of our products, and expanding the range of commemorative themes beyond the athletic, military, and veteran themes that have dominated coin programs over the past decade. The Citizens Commemorative Coin Advisory Committee will address the matter of commemorative themes in its 5-year plan to be issued later this year. The Mint has already begun a major effort to improve customer service by cutting in half average order fulfillment times and improving responsiveness at our customer service center.

I want to take this opportunity to thank President Clinton for the honor of this nomination and Secretary Bentsen for his continuing support and confidence. I also want to thank my wife, Jacquita, and my sons, Michael and Alex, for the patience with which they have accommodated the demands of life in official Washington.

That concludes my statement. I am happy to answer any questions the Committee might have.

STATEMENT FOR COMPLETION BY PRESIDENTIAL NOMINEES

Name: DIEHL (LAST) PHILIP (FIRST) NOEL (OTHER)

Position to which nominated: DIRECTOR OF THE U.S. MINT

Date of nomination:

Date of birth: 11 (DAY) 6 (MONTH) 51 (YEAR)

Place of birth: Dallas, Texas

Marital status: Married

Full name of spouse: Jacquita Pearson Diehl

Name and ages of children: Soren Michael Diehl - 10
Alex Douglas Diehl - 6

Education:

Institution	Dates attended	Degrees received	Dates of degrees
Austin College	8/69-5/73	BA	5/73
Univ. of Texas - Austin	9/74-5/76	MA	5/76
Stanford University	9/76-3/78	-	-

Honors and awards: List below all scholarships, fellowships, honorary degrees, military medals, honorary society memberships, and any other special recognitions for outstanding service or achievement.

Academic Fellowship - Stanford University

Memberships: List below all memberships and offices held in professional, fraternal, business, scholarly, civic, charitable and other organizations.

Organization	Office held (if any)	Dates
First Presbyterian Church, Dallas, Texas	None	1990-present
CASA (Court-Appointed Special Advocates, Austin, Texas	None	1987-88
Sigma Tau Epsilon (social fraternity) Austin College, Sherman, TX	President	1970-73
First Presbyterian Church Lubbock, Texas	None	1963-69

Employment record: List below all positions held since college, including the title or description of job, name of employment, location of work, and dates of inclusive employment.

1. Great Plains Construction Co., Lubbock, TX. Pipeline construction laborer and equipment operator, 1973.
2. La Quinta Motor Inns, San Antonio, TX; Motel Manager, 1974-1976.
3. Bob Bullock of Texas State Comptroller, Austin, Texas; campaign consultant, 1974
4. Texas State Comptroller's Office, Austin, Texas; public policy research , 1976
5. Pilsbury Madison & Sutro, San Francisco, CA., constitutional law research consultant, 1977
6. Stanford University, Stanford, CA.; teaching assistant, 1977-78
7. Stanford University and Diehl Enterprises, Austin, Texas; house painting, 1977-81
8. Texas Comptroller's Office, Austin, TX ; economic/public policy research, 1981-85

(see continuation sheet)

Employment Record (Continued)

9. Texas Public Utility Commission, Austin, TX.; Director-Telephone Regulation, 1985-88.

10. International Telecharge, Inc., Dallas, TX.; V.P.-Regulatory Affairs, 1988-1990.

11. U.S. Senator Lloyd Bentson, Washington, D.C.; Legislative Director and Staff Director, Senate Finance Committee, 1991-1993.

12. U.S. Department of Treasury, Washington, D.C.; Chief of Staff and Executive Deputy Director of the U.S. Mint, 1993-present.

Government experience:

List any experience in or direct association with Federal, State, or local governments, including any advisory, consultative, honorary or other part-time service or positions.

1993 : U.S. Dept. of Treasury, Chief of Staff to Sec. Lloyd Bentsen

1992-93: Staff Director, Senate Committee on Finance

1991-92: Legislative Director, Senator Lloyd Bentsen

1988-90: V/P,Regulatory Affairs, International Telecharge, Inc., Dallas

1985-88: Director of Telephone Regulation, TX. Public Utility Commissio

1981-85: Economic/public policy research, TX. State Comptroller's Offic

1976 : Public Policy Research, TX. State Comptroller's office.

Published writings:

List the titles, publishers and dates of books, articles, reports or other published materials you have written.

None

Political affiliations and activities:

List all memberships and offices held in and services rendered to all political parties or election committees during the last 10 years.

* Served as precinct judge (election officer) in Hays County, Texas, in 1986-87.
* Active in 1984 Gary Hart President Campaign during primary in Travis Co., Texas.

Political contributions: Itemize all political contributions of $500 or more to any individual, campaign organization, political party, political action committee or similar entity during the last eight years and identify the specific amounts, dates, and names of the recipients.

None

Qualifications: State fully your qualifications to serve in the position to which you have been named. (attach sheet)

SEE ATTACHMENT

Future employment relationships:

1. Indicate whether you will sever all connections with your present employer, business firm, association or organization if you are confirmed by the Senate.

   Not applicable

2. As far as can be foreseen, state whether you have any plans after completing government service to resume employment, affiliation or practice with your previous employer, business firm, association or organization.

   No

3. Has anybody made you a commitment to a job after you leave government?

   No

4. Do you expect to serve the full term for which you have been appointed?

   Yes

QUALIFICATION FOR DIRECTOR OF THE UNITED STATES MINT

* Five months experience in senior management of the U.S. Mint

* Considerable knowledge of the programmatic and management challenges facing the U.S. Mint

* Extensive experience with congressional relations, both programmatic and appropriations processes

* Excellent working relationship with constituencies of the U.S. Mint

* Knowledge of the decision-making process, and immediate access to senior management, of the Treasury Department

* Strong public and private sector management experience and skills

* Solid foundation in market-based economics

* Experience with improving the competitiveness of monopolies like the U.S. Mint

* Strong commitment to bringing sound business practices and a customer-driven focus to the U.S. Mint

* Excellent work ethic and high-energy commitment to getting results

Potential conflicts of interest:

1. Describe any financial arrangements or deferred compensation agreements or other continuing dealings with business associates, clients or customers who will be affected by policies which you will influence in the position to which you have been nominated.

None

2. List any investments, obligations, liabilities, or other relationships which might involve potential conflicts of interest with the position to which you have been nominated.

~~None~~

3. Describe any business relationship, dealing or financial transaction (other than taxpaying) which you have had during the last 10 years with the Federal Government, whether for yourself, on behalf of a client, or acting as an agent, that might in any way constitute or result in a possible conflict of interest with the position to which you have been nominated.

None

4. List any lobbying activity during the past 10 years in which you have engaged for the purpose of directly or indirectly influencing the passage, defeat or modification of any legislation at the national level of government or affecting the administration and execution of national law or public policy.

None

5. Explain how you will resolve any potential conflict of interest that may be disclosed by your responses to the above items.

None to resolve

Civil, criminal and investigatory actions:

1. Give the full details of any civil or criminal proceeding in which you were a defendant or any inquiry or investigation by a Federal, State, or local agency in which you were the subject of the inquiry or investigation.

None

2. Give the full details of any proceeding, inquiry or investigation by any professional association including any bar association in which you were the subject of the proceeding, inquiry or investigation.

None

RESPONSE TO WRITTEN QUESTIONS OF SENATOR RIEGLE FROM ALAN S. BLINDER

Q.1. Do you believe we can get further reductions in the unemployment rate without causing a reacceleration of inflation? How low an unemployment rate can we realistically expect to sustain? What policies would you advocate that would allow us to safely reduce unemployment beyond that level?

A.1. The margin of effective slack in the labor markets has been materially reduced over the past couple of years, and the unemployment rate is now near the range of estimates of the "natural rate of unemployment" reported by serious analysts. In my own view, a number close to 6 percent by current measurements is a reasonable estimate of that rate in today's labor market, but the change in the data starting in January 1994 has created uncertainty in this regard. If 6 percent is right, there is still some room for above-trend economic growth before we enter the inflationary zone. But no one should overstate the precision of this estimate.

As you suggest, we should certainly be looking for policy tools that might reduce the natural rate and permit us to maintain lower levels of unemployment without inflationary consequences. The Administration has advocated a range of programs intended to improve labor market information flows and to facilitate training that should better match workers' skills with areas of expanding job opportunity. I believe that these are important complements to monetary and fiscal policies that seek to keep economic activity close to potential.

Q.2. President Clinton promised that his Administration would create 8 million jobs. Are we on target for that?

A.2. Yes, we are. Payroll employment increased more than 12.8 million over the 15 months between January 1993 and April 1994—a pace that, if maintained, would produce a gain well in excess of 8 million by January 1997. The consensus forecast for GDP growth is consistent with 8 millions jobs over 4 years.

Q.3. Over the past 2 years, our trade deficit has resurged. Net imports of goods and services have risen from $7 billion at an annual rate to $82 billion. Our economy's recovery and others' stagnation accounts for much of the change, but it is clear that we have not made much progress in balancing our foreign accounts. In your view, what are the long-run consequences of these continued huge trade deficits? What do we need to do that we are not doing to reduce them?

A.3. As you point out in your question, nearly all of the rise in net imports of goods and services, or in the deterioration of our current account, over the past 2 years can be explained by the growth of the U.S. economy relative to that of our trading partners. Our external accounts should benefit as the economies of our major trading partners recover and their rates of economic growth approach ours. However, even the 1993 U.S. current account deficit, at 1.7 percent of GDP, was substantially below its peak of 3.6 percent of GDP in 1987 and is thus viewed by many observers as less troublesome—especially in light of the cyclical character of much of the deficit.

Nevertheless, the U.S. current account deficit must be financed by capital inflows from abroad that increase our external indebtedness. In the long-run, the United States will have to run a surplus in goods and services in order to service the increased external indebtedness.

The large U.S. external deficits are, by definition, the excess of U.S. domestic investment over U.S. domestic saving. In the final analysis, we must either increase Government saving by reducing the U.S. structural budget deficit or increase private saving relative to the rates of private investment in order to reduce our external deficit.

Q.4.a. While I think CRA can be improved, the bank regulatory agencies' proposal to reform CRA represents a significant improvement over the current regulation in shifting the focus to performance. The proposal includes data collection on small business and consumer lending by banks with more than $250 million in assets. It does not include the collection of those data by race and gender. Some have argued that data collection by race and gender would be burdensome. Others say it would be as useful in fighting discrimination as the HMDA data are in the housing area. Do you think the proposal is preferable to the current legislation?

A.4.a. I believe it represents a positive step in shifting the focus of CRA away from process and toward results.

Q.4.b. What are the proposal's strengths and weaknesses?

A.4.b. Again, I believe the proposal's chief strength lies in its focus on performance. The notion that small institutions should be subject to streamlined assessment processes also seems reasonable to me, though I am open-minded on the details. I would like to think further, however, about the proposed market share test. We must strike a balance between streamlining and effectiveness, while trying to steer clear of credit allocation.

These issues, as well as others raised in public comments, will need to be reviewed closely to ensure that the new CRA regulations not only emphasize performance, but also achieve the President's goals of making the examination process clear, predictable, and consistent.

Q.4.c. What do you think about the collection of such data by race and gender?

A.4.c. Insured depository institutions are obligated under CRA to meet the credit needs of their entire service area, and I understand that this data collection is intended to help examiners fully evaluate an institution's performance under that standard. That is an important goal. As I understand it, the specific proposal calls for collecting such data as the number of small business and consumer loan applications, denials, and the number and amount of approvals. Lenders would code this information by the location of the loan. Besides allowing a purely geographic analysis of lending, the data could also be analyzed by reference to the predominant income and racial makeup of the census tracts to which loans relate.

I have thought about the benefits that have accrued from the collection of data on race and gender that the Congress required in HMDA. I believe that data has served a useful public and regu-

latory purpose. It has helped to direct attention to issues of discrimination and has assisted in the enforcement of the fair lending laws.

With regard to CRA, however, the issue is more difficult, and I do not have a fixed position. With small business loans, for example, it may not be easy to determine whether a particular loan is to a "female" or "black" business. I certainly agree that the agencies should be willing to consider the idea of expanding data collection to race and gender. But I would prefer holding a final decision until I know more about the details. From my initial reading of the CRA proposal, the proposed data requirements appear to be reasonably related to evaluating CRA performance. But I have not yet read the many comments on the data issue. I am told that many commenters recommended expanding the data requirements to include the race and gender of individual applicants, but that some lending institutions are opposed to *any* new data collection requirements. The Board and the other agencies will have to analyze the merits of both arguments before adopting any final position.

Q.5.a. Recent studies indicated that minority borrowers are 60 percent more likely to be rejected for home mortgage loans than white borrowers. Evidence suggests that Federal efforts to enforce the Fair Housing Act and Equal Credit Opportunity Act have been minimal. Do you believe the Fed has done an adequate job in enforcing fair lending laws?

A.5.a. As an outsider to the Fed it is very difficult for me to answer your question. I do know that the Fed has referred several cases to the Justice Department, has conducted landmark research (such as the Boston Fed Study), and is upgrading its examination procedures to improve its detection of discrimination problems. But I am also aware of complaints about the Fed's record.

I know that improved enforcement of fair lending laws is very important to this Committee, and I could not agree more. I intend to make sure that the Fed adopts the best procedures possible on fighting discrimination. I understand that several Federal agencies are using, or considering using, "testers." As a social scientist, I have some sympathy with doing so at the Fed. "Testers" could fill an important gap in current procedures for detecting fair lending violations, and, of course, improved detection is the key to better enforcement. I intend to study this issue in the near-term future.

Q.5.b. What steps would you take to improve the Fed's record in this area?

A.5.b. I will have more ideas once I am on the Board. One important step I do know about is the use of a computerized statistical model, patterned on the Boston Fed study, which uses HMDA data to help examiners assess fair lending. The model enables examiners to match minority and nonminority pairs of applicants with similar credit characteristics, but different loan outcomes, better and more efficiently than was possible in the past. This should help identify any instances of discrimination. As mentioned in the previous answer, "testers" are another possibility.

Q.6. The banking agencies, HUD, and the Department of Justice recently published a policy statement on discrimination in the *Fed-*

eral Register. Some in the industry have criticized the statement for creating a catch–22 situation: encouraging banks to do self-testing then subjecting them to legal repercussions if they find instances of improper conduct by employees. What do you think the role of self-testing should be?

A.6. Encouraging voluntary self-testing to improve compliance with fair lending laws seems appropriate to me. I understand that many institutions want to test their operations to see if they can improve their minority lending. We should certainly encourage such efforts.

I recognize, however, that this advice seems to create a conflict for financial institutions who choose to test their performance under the fair lending laws. On the one hand, these efforts are commendable ways to help an institution correct any problems and ensure that all customers are treated fairly. On the other hand, I am told that the information produced by self-testing could be used against the bank. The problem needs to be addressed and, as I understand it, the policy statement seems to deal with this conflict in a reasonable way.

Q.7.a. Concerns about the extensive and rapidly growing involvement of banks in derivatives activities have been voiced by many. Others have pooh-poohed the risks and said the banks have the situation in hand. Are you confident that the regulators have the capability to adequately measure and constrain banks from taking on excessive levels of risk through derivatives activities?

A.7.a. Although the basic risks associated with derivatives are essentially the same risks that banks have traditionally managed, the complexity and diversity of derivative instruments and activities combine to make risk measurement and control more difficult than that associated with more traditional financial instruments. This complexity presents significant challenges to both banks and supervisors. Banks that are active in derivative markets must continue to enhance risk measurement techniques, strengthen risk controls, and make management systems more effective. Supervisors must continue to seek to strengthen procedures, policies, and techniques to ensure that these activities are conducted in a safe and sound manner. More disclosures may also be in order.

I understand that the Federal Reserve and other banking agencies have taken a number of important steps in supervising derivatives including establishing prudent capital requirements, developing effective on-site examination and off-site monitoring procedures, issuing guidance to banking organizations on sound risk management practices, and requiring adequate disclosure of, and accounting for, a bank's derivatives activities. While derivatives activities are now probably being effectively supervised by the Federal Reserve and other banking agencies, improvements can no doubt be made. One critical need, I believe, is better assessment of market risk. Given the size, complexity, and rapid growth of these markets, it is clear these activities will continue to require intensive supervisory attention.

Q.7.b. What steps would you recommend be taken by banks or their regulators in this area?

A.7.b. In my view, a bank's successful management of the risks associated with its derivatives activities depends critically on the

strength of its related policies, procedures, risk controls, and management information systems. To keep pace with the rapidly changing financial environment, including expansion of derivatives activities, both banks and regulators need to continue to enhance their procedures for managing and controlling risks. This effort will require increased management awareness and understanding of the nature of the risks assumed. It will also involve committing sufficient financial and managerial resources to the development of risk monitoring systems and to the back office, accounting, and auditing functions.

As pointed out in the answer to "7.a.," the Federal Reserve and other banking agencies have sought to ensure that the risks banks are assuming in their derivatives activities are being prudently managed and that adequate capital is held against risk exposures. The agencies have also developed effective examination procedures and accounting and reporting standards. I understand these efforts are on-going, both domestically and internationally, and I think they should be. I have yet to identify other specific steps that I believe should be taken with regard to the supervision of banks' derivatives activities.

Q.8. What risks, if any, do you see attributable to the recent significant expansion of banks in the area of mutual funds?

A.8. Banks have been engaged in mutual fund activities for a considerable period of time without significant problems. But the recent growth in bank sales of mutual funds has focused attention on certain aspects of these sales. The banking agencies have been concerned about possible customer confusion about whether mutual funds sold to bank customers are insured and the related possible loss of confidence in the bank if investments do not perform to the satisfaction of customers. I share those concerns.

The banking agencies have addressed these issues with a variety of policies governing sales practices and customer disclosures. The agencies monitor these policies through the examination process.

Recently, the four Federal bank and thrift regulatory agencies issued a joint policy statement that sets out a framework for the proper conduct of sales of mutual funds and other nondeposit investment products on bank premises. The Statement requires banks, at a minimum, to inform customers that these investment products are not insured by the FDIC, are not deposits and are not guaranteed by the institution, and are subject to investment risk—including the possible loss of principal invested.

To further minimize the risk of customer confusion, depository institutions are expected to separate the sale of mutual funds from deposit taking areas physically, not to use fund names that are identical to the bank's, and to obtain the acknowledgement of customers buying these investment products that the minimum disclosures have been received and understood.

Q.9. A proposal has been made for the financial institution regulators to use mystery shoppers to check on the mutual fund sales practices of the institutions they regulate. While some agencies have endorsed the idea, other regulators have voiced concern about entrapment, etc. Do you favor the use of mystery shoppers in this area?

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A.9. As I have indicated in earlier answers, I am open minded about testers. However, the banking agencies have recently issued a joint statement on the measures banks should take to ensure that consumers are fully informed about the nature and risks of their investments. Until such measures are shown to be inadequate, I question whether we should rush to use Government testers to check for compliance. But I would certainly not object to the use of testers by trade associations and the banks themselves.

Q.10. Serious concerns have been raised by some that our patterns of taxing, spending, and deficits are creating huge transfers between different generations. The generational accounting data in the President's budget appear to support that view. Are you concerned about this? What should we do about it?

A.10. Generational accounts call attention to potentially important intergenerational transfers that raise issues of both economic efficiency and equity—and that might otherwise be ignored. In this general sense, they are a valuable analytical tool. However, I have serious problems with several specific aspects of the methodology used in those calculations and would certainly not want to endorse the specific numbers in the budget as accurate. (The numbers were produced by private scholars, not by the U.S. Government.)

Q.11.a. Current law places a fairly sharp divide between commerce and banking. Some have proposed removing that divide to permit holding companies that contain both banking and nonfinancial business affiliates. What is your view on that?

A.11.a. There is a long tradition of separation of banking commerce, based on the American wariness of concentration of economic power and the view that banks must be disinterested providers of credit to all. Banking and commercial connections would put this principle at risk. Moreover, it is unlikely that a bank would maintain the same credit standards for affiliated firms. This is a particular problem for banks with Government guaranteed deposits. Firewalls and restrictions could mitigate the loan-to-affiliate problem, but not eliminate it.

It is argued that commercial firm purchases of bank holding companies would provide more capital and management resources for banking. But banking, when profitable, can attract the capital it needs. So I see few benefits and several potential costs in breaking down the wall between banking and commerce.

Q.11.b. One area where the divide between banking and commerce is not very sharp is nonbank banks. In 1987, Congress prohibited the formation of new nonbank banks and limited the growth of those then existing. Do you support the law limiting the growth of nonbank banks?

A.11.b. Commercial companies that own nonbank banks have a competitive advantage in combining banking and commerce that is not available to other commercial companies nor to bank holding companies. In closing the nonbank bank loop-hole, Congress permitted commercial entities to retain ownership of nonbank banks on condition that they be limited in size and scope. These limitations were intended by Congress to remain in place unless and until Congress enacts proposals to allow, with appropriate safe-

guards, banks and bank holding companies to compete on a more equal basis with grandfathered nonbank banks. There appears to me to be no compelling reason to remove these limitations now.

Q.12. Current law prohibits or greatly inhibits some financial services activities at bank holding companies including securities underwriting and insurance brokerage. What is your view about relaxing existing constraints?

A.12. I have mixed feelings on this issue. There are three basic principles that must be addressed: (1) public benefits; (2) the long-run health of banking in the United States; and (3) risks to banking safety and, soundness.

It seems clear that the public would benefit from greater competition and greater convenience if banks could sell insurance and underwrite securities. In addition, banks' familiarity with their business-customers creates a knowledge base that could be used to facilitate smaller firms' access to capital markets—if banks could underwrite securities.

Banks have been coming under increasing competition from other financial institutions in recent decades. It seems likely that banking will continue to contract, relative to total credit flows, unless banks are permitted to adapt to and evolve with technological and market developments. Although the public might suffer no loss if other institutions displaced banks, I do worry about a banking industry that is weakened this way.

But safety and soundness remain paramount concerns. There is virtually no risk to insurance brokerage, but securities underwriting and dealing does entail certain risks—though perhaps no more than longer-term bank loans. There also may be diversification gains to the banking organization as a whole, although the evidence on this point is modest.

On balance, when I weigh all these factors, I find myself mildly supportive of insurance brokerage for banks and repeal of Glass-Steagall. But I would like to consider the issue further.

Q.13. Current projections indicate that deposit insurance premiums for banks are likely to decline sharply within the next 2 years, as the bank insurance fund achieves its required minimum reserve ratio, while premiums for thrifts will need to remain 15 to 20 basis points higher for many years. Are there significant dangers in that scenario? Are large premium differences sustainable for long periods?

A.13. This is a real problem. One set of depositories is handicapped in competing with another if it is burdened by higher costs. It also seems unfair to continue to burden the surviving, healthy thrifts—most of which, by definition, did not engage in the risky and fraudulent policies of many failed thrifts—with the cost of the resolution of the failed entities. In short, the premium differential needs to be rethought.

Q.14. The Federal Reserve has the authority to charge bank holding companies for its examination and inspection but chooses not to. Ultimately that practice contributes to the budget deficit by reducing the Federal Reserve's contribution to the general Treasury fund, making the Federal Reserve the only Federal bank regulatory

agency which shifts examination costs from the institutions being examined to the taxpayers. What is your view of the Federal Reserve Board policy?

A.14. The Federal Reserve supervises bank holding companies to ensure that they operate safely and do not present a threat to the Federal safety net by abusing their subsidiary commercial banks. Substantial public interests are served in these oversight activities, and an argument can be made that the public should cover at least some of the costs. While the holding companies themselves derive some benefits from these activities, probably few organizations would voluntarily choose such supervision. At this point, I am inclined to the view that the Federal Reserve should recover some, if not all, of the costs it incurs in supervising holding companies. But before taking a firm position, I would like to familiarize myself with the details.

Q.15. Under 12 U.S.C. §326, the Federal Reserve is authorized to assess State member banks for the cost of their examinations. However, the Federal Reserve does not exercise its authority to levy such assessments. Consequently, even large State member banks that require significant regulatory resources, such as Morgan Guaranty, Bankers Trust and Chemical Bank, do not pay for their Federal exams. If the Federal Reserve were recouping money from State member banks, the amount recouped would add to the surplus that the Federal Reserve turns over the Treasury every year. By failing to assess these charges, the Federal Reserve is in effect forcing taxpayers to subsidize the examinations of State member banks. What is your view of this Federal Reserve Board policy?

A.15. My answer here is largely the same as my previous answer. One further point is that State member banks currently pay the same supervisory and regulatory costs as do nonmembers. They also make payments to their State banking departments to cover their share of the operating costs of those agencies, regardless of their Fed membership. Nationally chartered banks pay supervisory charges to the Office of the Comptroller of the Currency that are typically higher than those paid to State banking departments. That difference is effectively the only source of imbalance between national and State chartered banks, whether Federal Reserve members or not.

Correcting that imbalance by charging State member banks would create a new imbalance between State member and nonmember banks. So the question is a vexing one. Before taking a position on this matter, I would like to have the opportunity to study the question further.

Q.16. How do you address the issue that while the Federal Reserve's primary mission is to oversee monetary policy, it also has bank supervisory duties which present conflicts with its monetary policy mission?

A.16. I do not believe that these missions conflict, rather both monetary and supervisory policies are enriched by the other. The practical knowledge of banking and banking policy gained from supervision would appear to be a useful input to monetary policy, and stabilization responsibilities limit the narrow safety and soundness

focus that might otherwise come with supervision. In a world in which globalization of financial markets is a reality, financial crises will increasingly be international in nature and central bank cooperation is necessary. A central bank without supervisory knowledge, it seems to me, would be at a disadvantage in such cooperation.

Q.17. After passage of the last tax bill many economists were saying that this move would act to slow down the economy. The input of the tax increase has just hit on April 15. It will take some time to see if this will slow down the economy. Do you believe that the tax increase will have any deflationary consequences?

A.17. There is no question that the tax increases are currently taking some purchasing power out of the economy. But, given the character of the tax increases enacted, the advance notice taxpayers received, and the 3-year payment option, I would judge that the direct "drag" on consumer spending probably is not great. It must also be remembered that the tax increases are an important part of the deficit-reduction program, which is moderating the amount of pressure that the Federal Government is placing on the credit markets today—and that it will in future years if we maintain the OBRA93 disciplines.

Q.18. Do you agree that the legislative history of the 1980 Financial Institutions Deregulation and Monetary Control Act show that Congress intended the Federal Reserve, through pricing and other policies, to give private sector entities equality of competitive opportunity with the Fed in the provision of payment services, including automated clearinghouse services?

A.18. I have limited familiarity with this history. My understanding of the pricing provisions of the 1980 Financial Institutions Deregulation and Monetary Control Act ("MCA") is that these provisions, coupled with the MCA's expansion of access to Federal Reserve payment services to all depository institutions, were intended to provide incentives for the private sector to offer services to depository institutions similar to those offered by the Federal Reserve—including automated clearinghouse services. The resulting competition between the Federal Reserve and the private sector would tend to optimize the payment services available to depository institutions in terms of price, efficiency, and innovation.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR D'AMATO FROM ALAN S. BLINDER

Q.1. ***Price Controls—Health Care.*** Mr. Blinder in your extensive writings, you have covered the subject of mandatory price controls. I am quoting you in *Hard Heads, Soft Hearts* (1987): "Mandatory price controls substitute the political judgment of the State for the impersonal judgment of the market, thereby interfering with the signaling role of prices and impairing economic efficiency."

"In the early stages of a controls program the costs are small and almost invisible. But distortions mount and become concrete as a system of controls ages and ossifies."

I agree with these observations and have criticized the Clinton Administration health plan for the same reasons, although not in such eloquent terms. Were you consulted, as a member of the

Council of Economic Advisers, on the health plan? Did you give them this advice?

A.1. As a Member of the President's Council of Economic Advisers, I was involved in numerous discussions of health care reform over a period of many months. In the early stages of those discussions, "everything was on the table" in an almost literal sense, and I did indeed counsel against price controls of the sort we had in this country in 1971–74. Such controls were not adopted. The "premium caps" in the President's plan are something quite different. They do not specify prices for specific commodities or services, but rather give plan operators a budget and let them decide on prices and quantities within this budget. Such premium caps closely resemble the "price caps" which are now in wide use in public utility regulation.

Q.2. ***Fed Independence.*** I am concerned about the independence of the Federal Reserve, as a central bank and as a regulator. The Treasury's proposal to create a Federal Bank Commission has raised alarms over many issues, but especially the independence of the agency from the Administration. In short, independence is not to be taken lightly.

Can you assure the Committee that your experience and contact as a high level Administration economic official will in no way interfere with your service and judgment as the Vice Chairman of the Federal Reserve?

A.2. I can give the Committee this assurance with no hesitation what- ever. I understand very well that the role of Vice Chairman of the Fed is fundamentally different from the one I now fill as a Member of the Council of Economic Advisers. My current job, for example, is purely advisory and explicitly political; my prospective new job involves executive authority and is nonpolitical, even apolitical. As I noted in my written testimony, my current job is to serve only the President; my prospective new job is to serve every American—and to do so independently. Frankly, I find the contemplated transition an easy one since my entire professional life—prior to January 1993—was spent outside politics in a job with the most independence I can think of: A university professor with tenure.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR MACK FROM ALAN S. BLINDER

Q.1. Some people argue that the goal of monetary policy is price stability, i.e., zero inflation. Others say that the goal ought to be economic growth. What do you believe the goal should be, and why? Also, please explain whether you believe there is a difference between the goals of price stability and high, long-term economic growth. If so, why?

A.1. As I noted in my prepared statement, Congress has prescribed the goals of monetary policy in the Federal Reserve Act as: "to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates." So in my view, the Fed should be pursuing *all three* goals. My statement also noted that, if you take the long view about what is best for the economy, there are really no conflicts among the three goals.

Q.2. In your meeting with me on Wednesday, May 4, you stated—this is a paraphrase—that were you to be convinced that gold was a good indicator of incipient inflation, you would be more than willing to use it as a market signal. What evidence would you require in order to be convinced that the price of gold and market expectations of inflation are linked?

A.2. Shifts in market expectations of inflation may well be reflected in the price of gold because, as a durable commodity, gold can serve to some degree as a hedge against inflation. Historically, the price of gold has been elevated in periods of high inflation. However, gold prices can be affected by a number of factors other than expectations of U.S. inflation, including inflation developments in other nations, shifts in supply, and political instability in other countries. A fundamental problem in assessing the link between gold prices and market expectations of inflation is our inability to directly observe those expectations. In the absence of such observations I would want to see robust econometric evidence that gold prices do, in fact, help to predict future inflation. In the past, gold prices have not been consistently useful in making such predictions.

Q.3. Most of us agree that in a ceteris paribus world, budget deficits lead to higher interest rates. But because other factors affect interest rates, there is little evidence that an empirical relationship between budget deficits and interest rates exists. What do you believe is the most important factor *under Government control* that affects interest rates?

A.3. As I indicated in my prepared statement, I believe that prospects for the Federal budget have important effects on real long-term interest rates. Higher Federal debt—the result of higher budget deficits—does put added pressures on credit markets and therefore tends to push up real interest rates. Monetary policy also has important effects on interest rates. Shifts in the stance of monetary policy influence real interest rates in the short run. In addition, monetary policy, through its effect on inflation and inflation expectations, plays an important role in determining the general level of nominal interest rates.

Q.4. What effect does market uncertainty have on long-term interest rates? What is the magnitude of that effect? What is happening these days, in your view, to cause uncertainty in financial markets? Does the trade dispute between the U.S. and Japan contribute to this uncertainty? If so, what is the extent of that effect?

A.4. The purchase of a long-term debt instrument is an act of faith, since the investor is likely to be uncertain about the prospects for repayment (except for a Government bond), the purchasing power of the principal when finally repaid, and the total real return, including interest payments, the instrument provides while holding it. Increasing uncertainty about any of these factors should make investors more reluctant to buy the security. Financial economists, however, have had great difficulty in quantifying this effect, either in terms of reliably measuring the risk premia required to compensate investors for moving from short-term to long-term debt or for moving from domestic-currency to foreign-currency denominated debt. Those premia can be large, but they are also variable and dif-

ficult to relate to observed economic indicators, including market volatility.

Measures of financial market volatility have moved higher in the past few months, whether viewed in terms of backward-looking proxies of recent price changes or inferred from the prices of options on financial instruments. But the increases have not been unprecedented historically nor have they pushed these measures to record highs. Market participants do have a lot to be uncertain about: Incoming economic data suggest considerable more momentum to the economy than was thought just a few months ago, with consequent implications for pressures on prices and credit demands that are difficult to predict; monetary policy has recently changed direction for the first time in 5 years; newer participants in the marketplace, who have had little acquaintance with bear markets, may act skittishly; and, many aspects of Government policy—both here and abroad—are under active and public consideration. Among the latter influences, bilateral trade discussions between the United States and Japan have garnered their share of headlines. However, the possibility of a "trade war" with Japan is extremely remote and there has been no fundamental shift in the Clinton Administration's approach in dealing with this issue. So I myself do not attribute much importance to it.

Q.5. When the Federal Reserve increased the Federal funds rate recently, the expectation was that the dollar would rise on foreign exchange markets as market participants would seek higher-yielding dollar-denominated assets. Instead, the reverse has happened. Why, in your view, has the dollar fallen so dramatically? Do you agree with the subsequent decision of the Fed and other central banks to intervene? Do you believe that, in general, a policy of dollar depreciation will increase U.S. competitiveness?

A.5. As a rule, a tightening of monetary policy does normally produce some appreciation of the currency. In recent months, however, the dollar has weakened somewhat while the Federal Reserve has tightened. This is, indeed, surprising. Part of the explanation may be that while the Fed was tightening, new economic data were indicating that U.S. economic activity was stronger than market participants had previously thought. So market participants may have feared that the Federal Reserve was moving too slowly to prevent a resurgence of inflationary pressures. It was also said that the Administration welcomed a weaker currency, particularly against the yen. Indeed, it was partly to dispel this misperception that the U.S. and other monetary authorities intervened in exchange markets to purchase dollars against yen and marks, and accompanied these operations with a public statement by Secretary Bentsen. These operations were a well-timed and judicious use of the intervention policy instrument, and I fully support them.

In a literal sense, a cheaper currency does make a country more "competitive." But exchange rates are just one element in a country's international competitiveness. In the long run, exchange rates are determined by economic fundamentals and cannot be, artificially manipulated, especially when financial markets here and abroad are free and flexible. In the long run, the international com-

petitiveness of the U.S. is best assured by keeping inflation low and enhancing the productivity of American labor.

Q.6. Please describe your views on the effects of the expanding market for financial derivatives on the economy. Would you like to see greater regulation of the derivatives market? If so, what type of regulation would you recommend?

A.6. Financial derivatives allow risks to be unbundled and transferred to those most willing to assume and manage each risk component. That is a valuable function which should not be regulated out of existence.

Nonetheless, I would emphasize that derivatives include complex instruments which, if not properly understood and managed, can result in significant losses to individual institutions, as several recent episodes amply demonstrate. In addition, the question of whether derivatives have heightened systemic risks remains a subject of debate. Some fear that the failure of a major derivatives dealer could inflict serious damage on their counterparties, although the failures that have occurred to date were contained without systemic disruptions. Also, some believe that dynamic hedging of options portfolios has heightened the volatility of underlying asset prices. (But statistical studies do not support this belief.)

Whatever the true danger that derivatives pose to individual institutions or to the financial system, I feel that several key issues must be addressed to make sure these activities are on a sound footing. First, both regulators and market participants must implement sound risk management of derivatives activities. Banking regulators have a special responsibility to ensure that banks manage their derivatives activities prudently, so that the FDIC fund is not threatened. Second, the legal and institutional infrastructure for derivatives activities must be strengthened—especially as they pertain to cross-border transactions. Third, both the banking regulators and FASB need to strengthen accounting and financial disclosure standards for derivatives. Finally, market participants and regulatory authorities need to make sure that payment and settlement systems have the credit, liquidity, and operational safeguards necessary to cope with expanded volumes resulting from more active trading of derivatives and other financial instruments.

Q.7. You have been quoted as saying that your faith in the message sent by auction markets is declining. What makes you say this? What are the implications of your loss of faith in auction markets? Do you believe that markets nevertheless contain more wisdom than does the Government, or do you believe that the Government—the Fed, the Treasury, the SEC, whomever—has superior knowledge?

A.7. My training in economics has convinced me no mechanism is better than a free market in reconciling the unbounded wants of the public to the limited resources that are actually available. However, affirming that the market mechanism is superior does not imply that messages from markets are infallible. Policymakers must recognize that market behavior critically depends on expectations about the future, including what market participants believe future policy will be. On this last score at least, policymakers may know more than markets.

Shifts in expectations, which may well be amplified by the current moods of investors, can sometimes lead to price swings that are only loosely related to economic fundamentals. I believe you are referring to something I wrote around the time of Iraq's invasion of Kuwait: that the law of supply and demand could not explain the sizable swings in oil prices, which went as high as $40 a barrel. I thought that swing was excessive at the time, and history seems to have borne that view out.

While policymakers surely do not have more collective wisdom than the marketplace, they can and should view events from a longer perspective. Government policies that changed with every swing in market prices would only add to volatility. Instead, policymakers should consult a wide variety of economic indicators, including, but not limited to, market quotes, in framing their decisions.

Q.8. You have also been quoted that you would "penalize short-term security trading by imposing a small tax on transactions." Could you please explain your argument for this and explain why such a transactions tax would not lead to lower securities prices and subsequently to lower nationwide financial wealth?

A.8. You probably are quoting from an article I wrote for *Business Week* in April 1990 in which I listed a variety of tax code changes that might be worth considering—from the standpoints of revenue-raising effectiveness, economic efficiency, and fairness—in order to reduce the deficit. The argument that is suggested by your question is, I think, that a tax of this sort would tend to discourage short-term trading activity and thereby reduce market liquidity to some degree; this could lower securities prices, all other things equal.

But, it is not clear that all other things would indeed be equal. It is arguable that a small tax that inhibited short-term trading—but had negligible effects on long-term returns—would help to reduce risk premia by diminishing market volatility. If so, that would raise securities prices. And it is also arguable that, by refocusing the attention of market participants on the fundamentals of corporate asset valuation rather than on short-term trading, the markets would perform more effectively their role as an allocator of capital—clearly a boon to wealth creation.

I should also point out that, in that *Business Week* column, I packaged the transaction tax proposal with indexing of capital gains. On balance, I'd say the package was pro- not anti-capital.

Q.9. Another quote attributed to you is that the Reagan tax cut was an "ill-conceived tax giveaway," and that those who disagree have an "anti-tax obsession." In light of the fact that tax revenues subsequently grew dramatically and the effective tax burden was shifted even more to the wealthy, do you still believe the tax cuts were a mistake? Why?

A.9. I think these two quotes actually come from two different articles which had different focuses; indeed, I believe the second phrase was included in the article that was the source of your preceding question. The point I was making there was that I believed that we could not fix the deficit problem solely on the spending side; tax increases of some kind would be necessary. Be that as it

may, the thrust of the present question is my view of the wisdom of the Reagan tax cuts, and I shall focus on that.

What I had in mind in my remark was that the ERTA tax cuts were premised on unrealistic notions of the favorable supply side benefits that would be realized. I believe that the primary source of the subsequent growth of tax revenues was the traditional short-run stimulus to aggregate demand that tax cuts give, not any major effect on labor supply and the like (which is not to deny that taxes affect incentives; they do)..

Lower marginal tax rates, in themselves, do reduce the incentive for the wealthy to avoid taxes. But the shifting in "tax burden" to which you refer seems to have been more a result of the considerable shifts in income distribution that were attributable to a variety of non-tax factors, including widening wage differentials (associated importantly with education), and the greater gains the wealthy reaped from some of the booming financial markets of the 1980's.

Whatever their positive incentive effects, the 1981–84 tax cuts were unfortunate in that they were part of an overall budget program that created a major structural imbalance between revenues and outlays that generated massive increases in Federal debt. The deficit problem continues to this day. So, yes, I still think they were a mistake.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR FAIRCLOTH FROM ALAN S. BLINDER

Q.1. Dr. Blinder, you have described yourself as an "inflation dove," and have written that "the harm that inflation inflicts on the economy is often exaggerated." However, in our discussion in my office you also said that you think we can live with the current rate of inflation, but that no case can be made far going back to the higher rates of a few years ago. How much higher would you let inflation get before you would take any steps necessary to keep it down to present level?

A.1. As I noted in my prepared statement, it would be sheer folly to squander our gains against inflation. The first concern of the Federal Reserve today is to allow expansion to proceed without rising inflation. In light of the delays between monetary policy actions and their effects on spending and inflation, policy steps to forestall a prospective overshooting of the economy beyond its capacity, and hence a future acceleration of inflation, typically would need to be taken prior to any pickup in actual inflation. Indeed, the ideal policy would prevent a rise in inflation from ever occurring, although in practice surprise short-run events may make this an impossible standard to attain. Even so, as I indicated in my prepared statement, if the Federal Reserve resists such unlucky inflationary shocks but accepts disinflationary events, then we can continue to chip away over time at the already-low inflation rate.

Q.2. Many people worry about maintaining independent bank regulatory agencies, particularly in light of the situation in which the President finds himself. One of the principle forces which has slowed the Administration's plan to consolidate bank regulation under a board controlled by Clinton appointees had been the Fed-

eral Reserve. As a member of the Federal Reserve Board, what would your position on regulatory consolidation be?

A.2. As I said in my confirmation hearings, I am hopeful that a compromise can be reached that will achieve most of the objectives—including simplification and reducing complexity and costs to the Government and the banking system—while at the same time maintaining a significant independent role for the Federal Reserve in bank supervision. I pledged at that time that, after confirmation, I would make every effort to reach such a compromise.

Q.3. Dr. Blinder, how long have you known President and Mrs. Clinton?

A.3. Prior to joining the Administration during the transition, I had met with President (then Governor) Clinton only once—at a meeting of economists with the candidate in August 1992. I do not believe I met Mrs. Clinton at that time. To the best of my recollection, we first met—very briefly—at the Little Rock economic conference in December 1992.

Q.4. Outside of office and campaign work for the Clintons, in what other situations—such as Renaissance Weekends—have you interacted with them over the years?

A.4. As I just stated, I had never met either President Clinton or the First Lady prior to the campaign and the transition. Nor have I ever been to Renaissance Weekend. Since the Administration began, I have had many "office" contacts with the President, a few with the First Lady, and have also interacted with them socially a few times.

Q.5. This Administration has a history of its political appointees calling the independent agencies—getting and giving "heads up."

Dr. Blinder you work with Laura Tyson, of the University of California at Berkeley, at the Council of Economic Advisors. Janet Yellen, Mr. Clinton's other nominee for the Fed, also is from the University of California at Berkeley. As Vice Chairman of the Fed, if Laura Tyson calls you to talk about monetary policy—to get a "heads up"—what would you tell her?

A.5. Having served on the CEA since January 1993, I would be very much surprised if Laura Tyson called to talk about monetary policy—except in a very general, conceptual, way. Dr. Tyson, I, and others in the Administration have been careful never to question members of the FOMC about their decisions nor to ask them about upcoming FOMC decisions. I would expect that policy to be maintained. We have, however, often discussed a wide variety of conceptual issues involving monetary policy, fiscal policy, and the economy more generally with Fed governors. These conversations are useful to both sides, and I would expect them to continue.

My understanding is that, from time to time, the Chairman of the Federal Reserve does give the White House a "heads up" on imminent changes in monetary policy. When this happens, it generally is done by the Chairman, and I would expect this practice to continue.

Q.6. If you could solely determine our Nation's policy, would you be targeting interest rates, nominal GDP, some monetary aggregate, commodities prices, or something else? If you were monitoring

various targets, and those targets took divergent paths, which single measure of the state of our Nation's monetary status would you then regard as being most significant?

A.6. In my view, no single economic or financial variable provides reliable indications of growth tendencies and inflation pressures. In assessing prospects for the economy, I find it most useful to monitor a very broad range of economic and financial data. I do not regard any one measure as most significant. As I indicated in my testimony, ". . . the Fed really has no choice but to watch everything." To be sure, indicators can point in different directions, as you note. The task of the Federal Reserve Board and the Federal Open Market Committee is to weigh all available economic and financial information in the process of reaching judgments about appropriate monetary policy.

As to your specific list, I would put greater weight on nominal GDP and interest rates. Commodity prices are useful to the extent that they forecast overall inflation. At present, however, the traditional monetary aggregates are of little use.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR RIEGLE FROM STEVEN M.H. WALLMAN

Q.1.a. ***Mutual Funds***—Mutual funds are an increasingly important segment of the financial services industry. With assets of close to $3 trillion, mutual funds now rival insured bank deposits in importance to America's families. What changes, if any, do you think should be made in the area of regulation of mutual funds?

A.1.a. I believe the regulation of mutual funds is essentially sound. I understand that 2 years ago the Commission's Division of Investment Management released a report in which it reexamined investment company regulation (PROTECTING INVESTORS: A HALF CENTURY OF MUTUAL FUND REGULATION (1992)) and concluded that the approach of the Investment Company Act of 1940 had worked well and should not be fundamentally altered.

Although I do not believe the fundamental elements of the way in which mutual funds are regulated needs to be changed, I do believe the extremely rapid growth of the fund industry requires the Commission to address a host of significant regulatory issues. Recent surveys by the Commission and others, for example, cause me to be concerned about the level of understanding of the U.S. fund investor. The Commission needs to continue to consider ways in which to enhance disclosure by funds and to address issues arising in connection with the sales of mutual funds, particularly bank mutual funds. We should seek to determine, for instance, whether existing suitability rules are sufficient to protect fund investors. (Also see answer to question 1.b. below.) The Commission, in my view, must also evaluate its rules governing funds' use of derivative instruments to ensure that these rules strike a balance between promoting effective money management and protecting investors. I believe the Commission should also review the issue of portfolio managers trading practices and disclosures. (I understand the Investment Company Institute has recently released a report on this matter, and the Commission is nearing completion of its own study.) Finally, I believe an interesting issue that may benefit from

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Commission attention in the future relates to corporate governance matters and mutual funds.

The specific issues I have described are only examples of the myriad of issues I believe involve the fund business as it has grown. That growth has, as I understand it, far outdistanced the growth of the Commission's resources. Because over one-quarter of all American households have savings and retirement dollars in investment companies, the safety of investment company operations is extremely important to the economy. I believe assuring adequate Commission resources in this area should be a high priority of Congress and the Commission.

Q.1.b. A growing percentage of mutual fund sales are taking place in banks. Recent surveys suggest that banks customers may not be distinguishing between insured deposits and uninsured securities products. Can the SEC and the banking regulators coordinate their examination and enforcement efforts to ensure that bank customers receive the information they need?

A.1.b. I know the Commission, the National Association of Securities Dealers, Inc. ("NASD"), and the banking regulators have expressed concern that bank customers who buy securities on bank premises may not understand that those securities are not insured bank deposits. I understand that the Commission, the NASD, and the banking regulators have each taken a number of steps to counteract these misperceptions, including steps designed to ensure that customers receive disclosure that the securities in which they invest are not insured bank deposits. I further understand that Chairman Levitt and Comptroller Ludwig have met several times to discuss coordinating the Commission's and the Comptroller's regulatory, inspection, and enforcement efforts with respect to the sale of securities to bank customers, and that during the past few months the staffs of the Commission and the banking regulators have met to discuss coordination issues relating to bank securities sales. I also understand the NASD recently provided training and other assistance to the Federal Reserve Board regarding their examination program, and banking regulatory staff have been invited to participate in the Commission's comprehensive training program for broker-dealer examiners.

In addition, I believe strongly that investor protection should be the same regardless of whether a security is sold through a bank or broker dealer or otherwise.

Generally, I believe coordinated regulatory efforts are not perfect substitutes for rationalized and efficient regulatory structures. The disparate regulatory structure for bank securities activities as opposed to nonbank securities activities likely either causes duplication of scarce regulatory resources between agencies, or results in a lack of regulation or uneven regulation. For example, as I understand it, under the current system, broker-dealers on bank premises are being examined by both the SEC and the banking regulators. Further, as the difference between the current level of coordination and past levels of coordination show, the success of cooperative efforts may well depend on the personalities and goodwill of the principals involved. Ultimately, I currently believe that fur-

ther rationalization of the regulatory structure will be necessary to achieve consistent regulatory goals.

Q.2.a. ***Listing Foreign Stocks***—More than 500 foreign stocks from over 30 different countries now trade on U.S. stock exchanges. The SEC recently adopted rules changes designed to make it easier for foreign firms to list their stocks in the United States. This included allowing foreign companies to use international accounting standards that differ from U.S. accounting rules. Did the SEC strike a proper balance between encouraging listings of foreign stocks, while ensuring that U.S. investors receive appropriate information and protections?

A.2.a. The Commission's recently adopted international initiative to lower the costs of cross border offerings and listings maintains, I believe, the goal of providing investors with adequate information upon which to make an informed investment decision. As I understand it, the Commission's initiative focuses on providing foreign issuers the same level of efficiency in the registration process as available to domestic issuers through short form and shelf registration. In addition, recognizing the costs of transitioning into a new reporting and accounting system, particularly with respect to historical information, the initiative permits first time foreign entrants to provide reconciliation for the two most recent fiscal years and requisite interim periods; this transition provision does not change the number of years covered by the primary financial statements or selected financial data. Likewise, the increased significance thresholds for providing separate financial statements for equity investees and business acquisitions does not affect the requirement to present the separate financial statements, but rather the level of significance requiring reconciliation.

The Commission's action to allow foreign companies to prepare their Cash Flow Statements in accordance with International Accounting Standard No. 7, without reconciliation or supplementation, is, as I understand it, the culmination of a deliberate and considered process, during which the staff of the Commission commented on the improvements to IAS 7 as they were being developed. As I also understand it, the Commission's recent proposals to make use of IAS 21 and IAS 22 reflect the same deliberate, considered analysis of the quality of the information that would result from application of the standards. Both IAS 21 and IAS 22 were recently amended as part of the IASC's E32 Improvement Project—a project in which the SEC had substantial input through the work of the IOSCO Working Group on Disclosure and its Subcommittee on Accounting and Auditing. I believe the deliberateness with which the Commission has undertaken its consideration of using IASC standards is reflected in the careful and selective fashion it proposes to use IAS 22.

Q.2.b. How do we prevent a weakening of securities regulation by competition in laxity between exchanges around the world?

A.2.b. I strongly believe the tremendous success of the U.S. capital markets demonstrates that standards that are both high and cost-effective attract, not repel, participation of investors and issuers the world over. The best way to prevent a race to the bottom in securities regulation is to maintain the preeminence of the U.S.

capital markets as the most open, efficient, liquid, fair, and honest securities market in the world.

The U.S. market has more than 51 million individual investors participating in its securities market—multiples of the next largest market. I believe the Commission must, on a multilateral and bilateral basis, work with regulatory authorities in other jurisdictions to develop internationally recognized principles and standards that will promote the highest standards of market transparency, integrity, openness, efficiency, and stability. I understand the Commission has undertaken those efforts through the extensive bilateral MOU's and technical assistance agreements, regional cooperation through organizations like the Council of Securities Regulators of the Americas (COSRA) and global coordination through the International Organization of Securities Commissions (IOSCO).

Q.3. ***Corporate Governance***—Mr. Wallman, you have written extensively on corporate governance issues and the proper responsibilities of corporate boards. Many people believe that directors do a better job of carrying out their responsibilities when shareholders are able to communicate their views. Should the SEC be seeking ways to allow more dialogue between corporate owners and managers, rather than relying on shareholders to sell their shares if they are disappointed with management?

A.3. I strongly agree with those who state that there should be more dialogue between shareholders and managers. The Commission's recent actions in reviewing and amending its proxy rules have enhanced the opportunity for shareholders to communicate among themselves and with managers. The Commission, among other things, generally exempted from proxy statement disclosure requirements those shareholders not seeking proxy authority and permitted shareholders to announce their views on a matter subject to solicitation of proxies. My understanding is that these rule changes are working as intended, with the level of shareholder communication on matters of corporate performance and management having substantially increased, and with managers increasingly willing to meet with shareholders to discuss concerns and suggestions. As a Commissioner, I would continue to monitor this area to see if adjustments are necessary. I believe the Commission should, and as a Commissioner I would, continue to review the Commission's system of proxy regulation to see if further action should be taken to enhance shareholder communications between shareholders and managers and, more importantly, to facilitate a dialogue.

Q.4.a. ***Corporate Directors' Responsibilities***—In a 1991 *Stetson Law Review* article, "The Proper Interpretation of Corporate Constituency Statutes and Formulation of Director Duties," you wrote that corporate constituency statutes: "have arrested the recent misguided tendency of the corporate law to venture away from a corporation-focused concept toward the erroneous notion that the directors' duty is to act exclusively in the interests of the shareholders, with that interest increasingly defined by reference to short-term stock prices." Would investors be less likely to invest in corporations if directors were not required to act exclusively in their interests?

A.4.a. The passage of corporate constituency statutes does not deter investment. Approximately 30 States now have some form of corporate constituency statute. Corporate constituency statutes, as my article states, guide corporate law back to a corporation-focused concept, and away from a view that the only duty of corporate directors is to maximize the current share price. As noted in my article, recent case law in Delaware takes a similar tack. The longer-term interests of shareholders will be advanced, in my view, if directors and management focus on the best interests of the corporation as a whole. While some shareholders may be disappointed, in the short-term, in some corporate decision made using such an analysis, in the long-term what is in the best interests of the entity as a whole is in the best interests of the shareholders. As I stated in the article: "[B]y requiring directors to act in the best interests of the corporation, [the corporate constituency concept] assures shareholders that their money will be invested with the goal of enhancing long-term corporate wealth and the corporation's ability to maximize corporate profits."

The article further states that: "[u]nder the corporation-focused model, if the best interests of the corporation are not advanced by [a] takeover, the board, as a matter of fiduciary duty, need not accept the bid, regardless of the premium offered shareholders."

Q.4.b. Does this increase the ability of corporate managers to protect their own interests at the expense of shareholders?

A.4.b. No. Only if the corporation's best interest is not advanced would directors be permitted to reject the bid; in no manner does such a rule authorize conflicts of interest. Directors remain unable to prefer their personal interests over those of the entity, and would be liable for breach of fiduciary duty if they did.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR D'AMATO FROM STEVEN M.H. WALLMAN

Q.1.a. Over the last few years there has been tremendous growth in the over the counter market for derivatives. Some Members of Congress have expressed concern over the adequacy of regulation and the potential systemic risk associated with these new financial products. Do you think that the regulation of derivatives is adequate? Can it be improved? If so, how?

A.1.a. Federal securities, commodities, and banking regulators monitor the derivatives activities of certain dealers and end-users, such as banks, investment companies, futures commission merchants, and broker-dealers.[1] The Commission's net capital rule, for example, addresses credit and market risks assumed by broker-dealers in connection with their derivatives or other securities activities through the application of required net capital charges. I understand Commission staff, however, have been informed by certain broker-dealers that the capital requirements necessary to conduct OTC derivatives activities in registered broker-dealers is one factor among others, including business, economic, and legal con-

[1] Some entities that engage in derivatives activities, such as State banks and insurance companies, may be regulated by the States. Other dealers and end-users of derivatives, such as corporations, pension plans, and the unregistered subsidiaries and affiliates of broker-dealers, may be required under certain circumstances to report investment holdings to Federal or State regulators.

siderations, that has encouraged derivatives activities to be conducted in unregistered affiliates.

In addition to direct regulation of registered broker-dealers, I understand the Commission, through its risk assessment program, monitors any material risks to broker-dealers posed by the activities of their unregistered affiliates. Pursuant to the Market Reform Act of 1990, the Commission adopted risk assessment recordkeeping and reporting rules that provide the Commission with an overview of the financial and securities activities of broker-dealer affiliates. In this manner, I understand the Commission is able to monitor, to some degree, the otherwise unregulated activities of certain unregistered derivatives dealers.

I believe the existing securities regulatory structure goes far toward protecting investors and maintaining market stability, while remaining flexible to innovation. There are areas, however, in which I believe future change may be required to address derivatives activities, particularly those involving over-the-counter ("OTC") derivative products, both to facilitate and enhance the continuing development of a market that clearly serves a useful and desirable purpose, and to protect investors and the markets generally.

For example, various legal uncertainties surrounding the priority of certain instruments in bankruptcy could be clarified, as could the enforceability of various types of netting arrangements, thereby removing some associated risk. Better financial reporting and increased transparency would permit participants to evaluate better credit risk, and obtain further information to understand better market and liquidity risk. A continuation of cooperative efforts with other regulators overseas as well as domestically in coordinating an effective regulatory approach to OTC derivatives would also permit reduction in some of the uncertainties experienced by participants in the derivatives markets stemming from disparate regulatory and legal provisions and interpretations, and facilitate the increasingly necessary global review and monitoring, and any appropriate regulation, of these activities.

Changes in the net capital treatment of OTC derivative products that develop from the Commission's review of its capital standards may also encourage OTC derivatives activities now conducted in unregistered affiliates of broker-dealers to be brought within registered broker-dealers under Commission jurisdiction. Additionally, the establishment of one or more clearinghouses that specialize in the processing of trades in swaps may improve the current regulatory framework for certain instruments and certain participants in the swaps market by helping to ensure the legal certainty of swaps transactions and by improving settlement efficiency through payment netting. A swaps clearinghouse also would provide a focal point for coordination of industry practices and communication with interested regulators. While there are regulatory issues involved in the establishment of a swaps clearinghouse, I believe that regulators may usefully evaluate the development of such facilities.

Clearly, however, I believe the derivatives market is a fast growing and economically useful segment of the financial services marketplace, and that additional information and monitoring is necessary in order to formulate any appropriate regulatory provisions

that will benefit the reliability and integrity of the derivatives market, with the goal of enhancing innovation while reducing various risks to all participants and the markets more broadly.

Q.1.b. What are the risks associated with derivatives? How can they best be managed?

A.1.b. I understand there are numerous risks associated with the trading of derivative products, including market, credit, liquidity and systemic risks, the risk from leverage, as well as legal and operational risks.

Market risk is the risk of loss due to adverse price fluctuations and is present in all financial instruments. With respect to derivatives, market risk generally results from a change in the price of the security, index or yield of the instrument underlying the derivative.

In addition to market risk, OTC derivatives add another risk that is not present in standardized, exchange-traded products (but is present in many other securities or products). Unlike listed instruments that are cleared through a centralized clearing organization, OTC derivatives expose dealers and end-users to credit risk, that is the risk that a counterparty will default.

Another concern is the issue of leverage. Highly leveraged market participants can contribute to downward pressure on prices when they exit the market quickly as market prices begin to fall. Similarly, attempts to liquidate or utilize a hedged or other position may not be successful due to lack of liquidity in the marketplace. There is also a concern that increased activity in a derivative product, if there is a reduction in the liquidity and trading depth of the underlying product, may result in enhanced volatility and consequent mispricings of both products.

Finally, a major concern regarding the proliferation of derivatives trading is systemic risk. Systemic risk generally refers to the risk that a failure or significant disruption in the operation of a participant or group of participants may cause widespread difficulties throughout the financial markets. I understand that while derivatives, when used appropriately, can reduce risks, they also can generate large exposures for dealers and end-users and also may make it more difficult to contain and control a financial crisis.

I understand that an appropriate regulatory response to certain of these risks is the application of prudent capital standards. Adequate capital standards diminish leverage, limit counterparty exposure, and provide a cushion to protect dealers against market downturns.

Because much of the derivatives products market is relatively young, many legal uncertainties exist regarding the enforceability of derivatives contracts. Legal risk is the risk of loss because a contract cannot be enforced. One example of legal risk is the concern over the enforceability of netting provisions, whereby exposures from multiple derivatives contracts with one counterparty are netted. In the event of bankruptcy of the counterparty, there is a risk that the counterparty's receiver would seek to repudiate contracts under which the counterparty was obligated to pay money, while demanding payment on those contracts under which the counterparty was due money. There is clearly a need to eliminate uncer-

tainty over the enforceability of netting arrangements and (as also noted in the answer to 1.a. above), I support efforts to cooperate with other regulators and with industry to reduce uncertainties.

With respect to operational risk—the risk of loss that occurs as a result of inadequate internal systems and controls, human error, management failure or fraud—I believe strongly that the complexity of derivatives, which frequently are developed and priced only through the use of sophisticated mathematical models, requires special emphasis on maintaining adequate human and systems controls to validate and monitor transactions and positions. I believe enhanced financial disclosure and reporting will also be helpful in this context, as well as in the context of reducing some of the risks discussed above.

Q.2. This week the Senate passed a resolution expressing its concern over the impact of the Financial Accounting Standards Board's proposed accounting treatment for employee stock options. What are your views of the FASB proposal? Should the SEC try to influence the outcome of the FASB rulemaking? If so, how?

A.2. This is a complex and controversial issue that involves not only the determination of the most appropriate accounting, but also whether or how accounting standards setters should consider the economic, social, or political consequences of proposed accounting standards in determining whether to adopt those standards.

Since its creation in 1973, the FASB has fulfilled, I believe, its role as the primary private sector accounting standards setter in a credible and effective manner. The investing public has been served well by the Commission's policy to look to the FASB for leadership in the development and improvement of accounting standards.

The current FASB proposal has raised a number of concerns. One is the impact that any proposal to charge to expense the value of fixed, employee stock options is expected to have on the reported earnings of certain companies. The FASB contends, and I agree, that *it* is not qualified to address whether that impact outweighs the benefit that may be derived from making financial statements including such a charge available to investors. Other policymakers, including the Commission, are capable of addressing that issue.

The FASB proposal has also raised concerns as to whether a methodology exists to value employee stock options in a manner that will produce meaningful financial reporting. The resolution of that issue lies within the FASB's mandate. It is necessary to resolve satisfactorily that issue, in order for any final standard to achieve general acceptance. During the recently completed public hearings, roundtable discussions, and field test of the proposed accounting standard, a number of issues related to the measurement question were raised. I understand the FASB has stated its intention to consider all of those issues prior to issuing a final standard.

I also understand there are concerns as to whether there are other approaches the FASB could take that would provide the same information the FASB seeks to make available to investors, but without raising some of the concerns voiced by opponents of the current proposal.

Although the Commission looks to the FASB for leadership in developing and improving accounting standards, the Commission can-

not abdicate its responsibilities under the Federal securities laws for those standards. I understand the Commission has in the past closely overseen the FASB's activities with respect to each of the FASB's projects, and I would expect the Commission would do so here. I understand that accounting for stock-based compensation was discussed at length at a November 17, 1993 joint, open meeting of the Commission and the FASB. At that meeting, members of the Commission expressed concerns about the project but, I understand, also generally continued to express support for the FASB's process. I understand the Commission continues to monitor the FASB's progress on this project. I believe oversight and continued input is the appropriate role for the Commission at this time. I am very hopeful that the FASB process will result in a standard that recognizes and addresses the concerns of those opposed to the current proposal, while also recognizing and addressing the concerns of those in favor of the current proposal.

In the event the FASB issues a final standard that is consistent with the current proposal and that fails adequately to address the concerns of those opposed to that proposal, the Commission undoubtedly will be asked to consider overruling the FASB. It would be appropriate for the Commission to consider at that time whether the final standard results in financial reporting that is consistent with the Commission's statutory mandate.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR RIEGLE FROM PHILIP N. DIEHL

Q.1. ***Priorities***—If confirmed as Director of the Mint, what would be your top priorities?

A.1. If I am confirmed as Director of the United States Mint, I intend to pursue three priorities during my term. My first priority will be the implementation of an aggressive schedule of financial management improvements that will lay the foundation for the Mint to receive a clean, i.e., unqualified, opinion on its Audited Financial Statements within the next two years. The Mint has not received a clean opinion on the audits conducted to date by independent public accountants, as required by the Chief Financial Officers Act.

Second, I hope to work with the Banking Committee in finding a means of controlling the continuing proliferation in commemorative coin programs. The rapidly increasing number of coin programs is testing the limits of both collectors' willingness to buy and the Mint's ability to produce and market these programs in a business-like manner. The Citizens Commemorative Coin Advisory Committee, established by Congress in 1992, will be producing a report to Congress by the end of this year recommending a 5-year plan of commemorations and suggesting additional actions which might be considered to address this matter.

Third, there are opportunities on several fronts for the Mint to increase its productivity and profitability, thereby making a larger contribution to financing the Federal debt and increasing employment among the Mint's private sector suppliers. One opportunity is through the acquisition of more modern communications and manufacturing technology and the adoption of modern personnel management practices. Also, I believe there are opportunities, over the

mid-term, to expand coin collecting into geographic and demographic markets that in the past have not been active in numismatics. We must develop marketing strategies to expand the appeal of coin collecting into younger and more ethnically diverse markets in order to respond to the rising demands in Congress for these commemorative programs. And finally, the Mint must secure the loyalty of its long-time customer base, as well as its new customers, by rapidly improving customer service, enhancing the artistic appeal of our products, and expanding the range of commemorative themes beyond the athletic, military, and veteran themes that have dominated coin programs over the past decade.

Q.2. ***New Policies at the Mint***—A recent survey done by Mint officials showed that delays of 8 weeks or more were common in mail order operations. According to an article dated March 11, 1994 in the *Washington Post,* you have made some changes in the management of commemorative sales. The Mint has reduced the shipping time on mail orders of commemoratives to 6 weeks and is now allowing customers to cancel orders anytime before shipment. You commented that this was just the first step to dramatically improve service to customers. What are some of the other changes you have planned? Are there any legislative proposals that you could suggest which would assist you in your efforts to streamline the Mint's operations?

A.2. On February 7, 1994 the United States Mint announced a new commitment to delivering customer orders on a more business-like basis. A recent survey of Mint order fulfillment response time demonstrated that for recent programs our average was almost 8 weeks. This meant that about half of all orders required more than 8 weeks, and often as much as 3 to 4 months, to process. Our new standard is to deliver 99.9 percent of all orders within 6 weeks. Late last year we launched a major program consisting of some 28 separate tasks to meet this tougher standard in 1994. The first commemorative program subject to these new standards is the World Cup 1994 program. As of May 9, 1994, we have delivered 69 percent of all World Cup orders within 6 weeks, a significant improvement from the 15 percent record established in our final 1993 program, but still below our 99.9 percent standard. Our first two numismatic programs of the year, the 1994 Proof and Uncirculated programs, have met the 99.9 percent standard. As other programs are introduced we will continue to work toward meeting the 6-week standard.

As for other changes we have planned, we are implementing a series of improvements in telecommunications technology and customer inquiry systems at the Mint's customer service center to provide customers with ordering and account services equal to the best found in the private sector. As a part of this initiative, we are considering the installation of toll-free 1–800 service for customer inquiries to augment the 1–800 service already available for ordering Mint products.

The Mint is also aggressively seeking ways to improve both the artistic and technical quality of its coin products. On the artistic front, senior management is giving greater emphasis to artistic concerns and forging a closer working relationship on issues of ar-

tistry with the Fine Arts Commission and the Citizens Commemorative Coin Advisory Committee, both of which advise the Mint on coin designs. As for technical quality, the Mint has implemented a system of continual improvement to its coin products and packaging.

We are also continuing, and extending, an initiative begun in 1993 to offer a broader, and more interesting, range of product and packaging options designed to appeal to a wider range of numismatic customers. The World Cup 1994 program offers the widest variety of product options the Mint has ever offered and additional innovations will be offered in other 1994 programs.

The most significant legislative initiative that could be taken to streamlining Mint numismatic operations would be establishing an effective limit on the number of commemorative programs each year and the mintage levels authorized for those programs. There are significant and unnecessary inefficiencies created by the proliferation of multiple, overlapping coin programs which are often authorized at the last minute and then rushed into production. As demonstrated by an overall, steep decline in Mint commemorative sales over the last 7 years, there is growing collector resistance to a glutted coin market, where Mint products seldom hold their initial values. There is also increasing dissatisfaction with a perceived lack of collector impact on Mint commemorative themes. Before the end of 1994, the Citizens Commemorative Coin Advisory Committee will make recommendations related to these concerns.

As for circulating coin production, in the future I intend to present to the Committee a proposal to extend the Public Enterprise Fund to cover all Mint operations. This proposal is designed to produce significant efficiencies by streamlining financial, procurement, and production systems for the circulating half of our business and allow for the consolidation of the Mint's balkanized fund structure into a single, simplified revolving fund. Action on this front has been recommended by the Mint's external auditor, and I believe it is essential to meeting the requirements of the Chief Financial Officers Act and obtaining an unqualified audit opinion for the Mint's financial system.

Q.3. ***The Citizens Commemorative Coin Advisory Committee***—The Citizens Commemorative Coin Advisory Committee is responsible for recommending to the Director of the Mint, on an annual basis, themes for a 5-year period, mintage levels and reasons for their recommendations. As chairman of the committee, how do you perceive the status of the committee?

At the February 22, 1994 meeting of the Advisory Committee, I understand that the committee members decided not to recommend any additional coin programs for 1994 because there are too many approved programs for 1994 already. Do you believe there should be an absolute limit on the number of commemorative coins that Congress authorizes each calendar year?

A.3. The Citizens Commemorative Coin Advisory Committee was created by Congress in 1992 to advise the Congress and the Secretary of Treasury on the commemorative themes and associated mintage levels that should be considered for each of the next 5 years. Furthermore, in a Sense of the Congress resolution passed

late last year, Congress expressed its intent not to enact more than three coin programs for any year.

As enacted by Congress, the Committee's role is purely advisory and, in the end, it must depend upon the Congress to enforce any limitations on commemorative coin programs. The Committee is currently taking public testimony from advocates of proposed coin programs, seeking input from coin collectors on commemorative themes they favor, and developing objective criteria by which it will select programs for inclusion in its 5 year plan, which will be issued by the end of this year. To date, the Committee has not issued opinions on the merits of any proposed programs, but in its February meeting, the Committee recommended that no additional 1994 coin programs be authorized by Congress.

I believe there should be limits placed on the number of commemorative coin programs authorized each year. But more importantly, it is also necessary to limit the total annual mintage of all commemorative programs in order to address the glut of coins flowing into numismatic markets each year. If large coin programs on the scale of those of recent vintage continue to be mandated, limiting the number of coin programs will be inadequate to preserving, and eventually expanding, the potential of this market. Under current market conditions, the Mint can generally expect to sell no more than three to four million coins a year, even if many millions more are authorized. So long as coin programs are authorized without limits recognizing the realities of this market, coin sales are likely to continue their 7-year decline.

Q.4. ***The Penny***—Do you believe that the penny should be eliminated? If so, what impact could the elimination of the penny have on cash transactions by consumers? What effect will the elimination of the one cent have on sales tax transactions?

A.4. Despite the fact that the penny has lost some 80 percent of its value to inflation over the past 30 years, it is still the most widely-used coin manufactured by the United States Mint and represents between 70 and 80 percent of the Mint's total annual coin production. In 1994 alone, we expect to produce 12.6 billion pennies. The penny is marginally profitable for the United States Government; associated costs are about 20 percent less than the face value of the coin, providing a very small, but still positive, seigniorage margin to the Federal treasury.

A May 1990 GAO study entitled "National Coinage Proposals. Limited Public Demand for New Dollar Coin or Elimination of Penny" studies these issues and noted: "There is no . . . economic argument for eliminating either the penny or the half dollar coin. Both are profitable to the Government in that their face value exceeds their production and distribution costs. Demand for the penny remains high. While retail trade associations and the public recognize some nuisance aspects of the penny, the problems inherent in rounding off retail transactions to the nearest 5 cents were troubling to many. The European countries that have eliminated their lowest denomination coins all did so because the production costs exceeded their face value."

"Overall, general public participant reaction . . . was negative. Most believed that businesses would increase their prices and ex-

pressed concern for the poor, who could not afford losses from rounding ups. Business group participants were concerned that rounding would result in bookkeeping problems, tedious verbal explanations of rounding to consumers, short-term costs involved in cash register adjustments or purchase of software to accommodate automatic rounding, and rounding losses particularly for banks when cashing checks that round up."

State sales tax authorities questioned by GAO thought that the rounding rule would not affect or impose significant problems in the collection of sales taxes. However, they did express concern that merchants might try to set prices so that rounding would benefit them. Further, Virginia State sales tax officials thought that rounding should be applied to all forms of payment, including checks and credit cards. "They reasoned that people who do not have access to checking accounts or credit cards, most likely poor people, would pay the rounded amount, whereas people who do have access to checks or credit cards would pay the unrounded amount. They also noted that converting cash registers to compute the rounded price would be a burden on merchants."

Q.5. The Susan B. Anthony dollar coin was introduced in the late 1970's and faced many problems which proved to be insurmountable. I understand the Mint has over 300 million Susan B. Anthony dollars held in Mint and Federal Reserve inventories. What has the Mint done to try to reduce the inventory?

A.5. As of May 6, 1994 there were approximately 345 million Susan B. Anthony (SBA) dollar coins in combined inventories at U.S. Mint facilities, the Federal Reserve Banks, and the 25 Federal Reserve Branches. The SBA dollar coin is being used in transit systems in Baltimore, New York City, and Philadelphia. The Detroit Branch of the Federal Reserve Bank of Chicago has reported increasing demand for use in vending machines. The SBA dollar coins are also available through depository institutions at face value. We sell the 1979- and 1980-dated uncirculated versions to Mint customers in sets (by year/production facility) and bags ($100 and $2,000). I also understand that as of June 1993, the U.S. Postal Service began installing stamp vending machines at post offices nationwide that will accept a $20 note and dispense SBA dollar coins as change. If legislation for a new one-dollar coin is enacted, the coins remaining in inventory should be melted, with the metal recycled in other coins. The seigniorage previously credited from the SBA dollar coin would need to be adjusted on a dollar-for-dollar basis against the seigniorage from other coin denominations.

Q.6. ***Patronage Jobs at Mint***—According to a December 10, 1993 article in *The Washington Post,* there are plans to eliminate nine patronage jobs and depend on career civil servants to run the agency. Secretary Bentsen said that he wants the superintendents and assayers at all Mints as well as the chief engraver sculptor in Philadelphia, to be career employees. (All the positions have been patronage jobs since 1873.) What is your position regarding career civil servants running the agency? What qualifications are necessary for these positions?

A.6. I support Secretary Bentsen's November 1993 decision to ask the Congress to eliminate nine Presidential appointment positions

at the United States Mint. The appointed positions are the four field Mint superintendent positions at the U.S. Mints in Philadelphia, Denver, San Francisco, and West Point, New York; the four assayer positions in each of these Mint facilities, and the Chief Engraver position at the Philadelphia Mint.

This action is designed to streamline and strengthen the management of the Mint by eliminating Presidential appointments that are vestiges of the 19th Century era of political patronage. The Mints at Philadelphia, Denver, San Francisco, and West Point are production facilities more appropriately managed by professional career specialists than by political appointees. A high level of management and manufacturing experience is necessary to deal with the demands of producing some 18 billion circulating coins a year, the administration of numismatic and bullion coin programs, and the implementation of improvements in financial management systems mandated by Congress.

The Secretary's plan calls for the Mint superintendent positions to be converted to professional career positions and filled on a competitive basis; the remaining five political positions would be abolished. All of these positions are currently vacant.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR D'AMATO FROM PHILIP N. DIEHL

Q.1. Recently, we have seen a proliferation of commemorative coin programs. News articles have accused Congress of "killing the golden goose." Do you agree that there are too many programs and do you believe each existing program suffers when another coin bill is passed?

A.1. I believe there should be limits placed on the number of commemorative coin programs authorized each year. But more importantly, it is also necessary to limit the total annual mintage of all commemorative programs in order to address the glut of coins flowing into numismatic markets each year. If large coin programs on the scale of those of recent vintage continue to be mandated, limiting the number of coin programs will be inadequate to preserving, and eventually expanding, the potential of this market. Under current market conditions, the Mint can generally expect to sell no more than three to four million coins a year, even if many millions more are authorized. So long as programs are authorized without limits recognizing the realities of this market, coin sales are likely to continue their recent 7-year decline.

Q.2. The topic of the minting of a new dollar coin has been endlessly discussed. A total of 857.2 million Susan B. Anthony Dollar Coins were minted between 1979–81, most of which are in circulation. According to the latest available figures, the Mint's inventory of the Anthony coins is nearly 295.7 million, with the Federal Reserve holding another 63.5 million of the coins. This number has significantly decreased over the past 6 months. You should be commended for your efforts in trying to get the rest of the coins out of public vaults and get them into private hands. What else could be done to get more of these coins into circulation? Should the coins in storage at the Mint and Federal Reserve be melted down?

A.2. I understand that the SBA dollar coin is now being used in transit systems in Baltimore, New York City, and Philadelphia. The Detroit Branch of the Federal Reserve Bank of Chicago has reported demand for use in vending machines. The SBA dollar coins are also available through depository institutions at face value. We sell the 1979- and 1980-dated uncirculated versions to Mint customers in sets (by year/production facility) and bags ($100 and $2,000). We have seen an increase in demand for the SBA since June of 1993 when the U.S. Postal Service began installing stamp vending machines at post offices nationwide that accept a $20 note and dispense SBA dollar coins as change. I am skeptical that there is much more that the Mint, unilaterally, can do to increase demand for the SBA.

If legislation for a new one-dollar coin is enacted, the SBA coins remaining in inventory should be melted, with the metal being recycled in other coins. The seigniorage previously credited from the SBA dollar coin would need to be adjusted on a dollar-for-dollar basis against the seigniorage from other coin denominations.

Q.3. Many studies have been issued concerning the amount of money the Government could save by issuing a new dollar coin. How much would a dollar coin save the United States Government if the dollar bill would remain in circulation? How large of a savings would there be if the dollar coin would totally replace the dollar bill?

A.3. The Treasury Department is currently reviewing these studies and the claims of interested parties. However, I have no doubt that retention of the dollar bill, along with the introduction of a new dollar coin, would cause the coin to fail. Recent efforts to introduce dollar coins, including the Eisenhower dollar in 1971 and the Susan B. Anthony in 1979, failed largely due to the retention of the dollar bill. The public has consistently resisted converting from bills to coins, and in fact, a 1990 Gallup poll found that only 15 percent of the public favored replacing the bill with a coin. The General Accounting Office (GAO), in both its 1990 and 1993 studies, has acknowledged the need to not only eliminate the dollar bill to ensure the success of a new dollar coin, but to also prepare the American people beforehand for the transition.

Estimates of annual Federal budget savings with the introduction of a new dollar coin and the elimination of the dollar note vary. In its latest report, the GAO, citing a 1992 Federal Reserve study, estimates that the United States could save an average of $395 million per year by substituting the dollar note with the dollar coin. The Treasury Department agrees that if the dollar coin successfully circulates, cost savings will be realized. However, since there are a great many unknowns, such as demand for the dollar coin, increased demand for the two dollar bill, and metal costs, predicting cost savings with confidence is difficult.

Moreover, since the potential savings are weighed in the "out-years" of these estimates, initial 5-year savings are likely to be modest. In a 1990 GAO Report on dollar coin (which estimated annual savings of $318 million over 30 years) Government costs were projected to actually increase by $80 million during the first year of production, and the annual projected savings level of $318 mil-

lion would not be reached until 13 years after production of the coin began.

Finally, a number of other factors must be considered to make the introduction of a new dollar coin a success. The Mint would need at least 30 months from the time of the legislation's enactment to the introduction of a new dollar coin. This lead-time is required to design, test, and produce production quality dies. Research and development is required to determine the optimum alloy, coining and color tests on the alloy and wear tests on the alloy. A commitment to fund a marketing awareness program is also necessary to prepare the American public for the transition from a dollar bill to a dollar coin. Such a program was an important component in the successful effort of the Canadian government to introduce their new dollar coin.

Q.4. What are your views on the elimination of the penny? Is that a realistic possibility?

A.4. Despite the fact that the penny has lost some 80 percent of its value to inflation over the past 30 years, it is still the most widely used coin manufactured by the United States Mint and represents between 70 and 80 percent of the Mint's total annual coin production. In 1994 alone, we expect to produce 12.6 billion pennies. The penny is marginally profitable for the United States Government; associated costs are about 20 percent less than the face value of the coin, providing a very small, but still positive, seigniorage margin to the Federal treasury.

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access to checks or credit cards would pay the unrounded amount. They also noted that converting cash registers to compute the rounded price would be a burden on merchants."

Q.5. The Citizens Commemorative Coin Advisory Committee which you chair is expected to release their report in December on recommendations for commemorative coins until 1999. Your report will be non-biding recommendations. As chairman, how will you encourage Congress not to pass coins that the Advisory Committee have not recommended?

A.5. Quite frankly, I don't have a solution to offer yet. However, I intend to work closely with the Committee in finding a means of controlling the continuing proliferation in commemorative coin programs. The rapidly increasing number of programs is testing the limits of both collectors' willingness to buy and the Mint's ability to produce and market commemoratives in a business-like manner.

I expect the Citizens Commemorative Coin Advisory Committee to encourage the Congress to establish a firm, effective limit on the number of commemorative programs each year and the mintage levels authorized for those programs. If large coin programs on the scale of those of recent vintage continue to be mandated, limiting the number of coin programs will be inadequate to preserving, and eventually expanding, the potential of this market. Under current market conditions, the Mint can generally expect to sell no more than three to four million coins a year, even if many millions more are authorized.

There are significant and unnecessary inefficiencies created by the proliferation of multiple, overlapping coin programs which are often authorized at the last minute and then rushed into production and marketing. As evidenced by the overall steep decline in Mint commemorative sales over the last 7 years, there is growing collector resistance to a glutted coin market, where Mint products seldom hold their initial values, and increasing dissatisfaction with a perceived lack of collector impact on Mint commemorative themes. By the end of 1994, the Citizens Commemorative Coin Advisory Committee will make recommendations related to these concerns.

It is important to note, however, that the Committee's role is purely advisory, and in the end, it must depend upon the Congress to enforce any limitations on these programs. Both as the Chairman of this Citizens Committee, and as Director of the Mint, I will work closely with the Committee to address this mutual concern.

Q.6. Recently, some organizations who had received surcharges from the sale of commemorative coins have complained that the Mint had not sufficiently marketed their coin programs. Part of their complaint is that the profit the Mint made off the programs should have been put back into marketing the coins. What is your view on this? Should the groups who will receive surcharges be responsible for marketing the coins beyond the initial mailings from the Mint?

A.6. I believe there are ways for the Mint to increase the effectiveness of its marketing of commemorative programs. However, based on 7 months of close observation, I have concluded that the Mint's marketing staff do very well under the circumstances they face. For

example, in 1994, the Mint marketing staff is juggling the management of six commemorative programs plus another four annual numismatic programs as well as the gold and silver American Eagle bullion programs. Five of the 1994 commemorative programs were not enacted until late November 1993, with the mail drop-date of the first of these five programs coming less than 5 months after the legislation was signed into law. This is a remarkably short period of time to bring to market a program expected to raise some $18 million in gross revenue.

However, I believe the source of the complaints you referenced have little to do with how the Mint marketing staff confronts these management challenges. Instead, I believe it relates, as your question suggests, to the fact that the Mint seeks to conserve a profit from these programs.

As commemorative programs are currently structured under the law, sponsoring organizations receive a surcharge set by law for each coin sold, irrespective of whether the program ultimately makes a profit or ends in a loss. In a nutshell, sponsors have a strong economic incentive to drive the Mint to spend, as an example, $10 to market a coin from which they will derive a $5 surcharge, because the $10 marketing expenditure has no effect on their return from the program. This is not simply a matter of economic theory; some sponsoring groups have behaved in precisely this fashion.

I would recommend against making sponsoring groups responsible for any portion of the marketing of commemorative coins. To do so would open the programs to potential abuses by organizations that have strong short-term profit motives and virtually no long-term stake in numismatic markets. Instead, I recommend developing a way of structuring these programs so that the Mint and the sponsoring groups share the same incentive to ensure that each program is sustainable by its own revenues. I am not prepared to make a specific recommendation at this time, but I'm convinced this is achievable.

Q.7. Commemorative coin programs have been viewed by some groups as an easy way to earn a couple of million dollars without having to risk a dime of their own money. Due to the rise in the cost of precious metals and increase production costs, the price of the coins has risen. The total cost of the coins is increased by added surcharges. These surcharges range anywhere from $10 for the clad World Cup coins to as much as $50 for the gold 1996 Olympics coins. Do you feel these surcharges are a tax placed upon the coin buying community? Should the surcharges be eliminated?

A.7. There is no question that the surcharges are an added cost placed upon the coin which is then borne by the coin buying community. There are those in the coin buying community who feel that the surcharges are not warranted and that these coin programs are being used by sponsoring groups only to raise money for their particular cause irrespective of whether that cause is worthy of a national commemoration.

I believe the question of surcharges and the allocation of risk between the Mint and sponsoring groups is something that needs to be evaluated in the overall context of the continuing proliferation

of commemorative coins. I am not prepared to offer a proposal at this time, but I think this matter is likely to be addressed by the Citizens Commemorative Coin Advisory Committee in its report to this Committee later this year.

WHY ARE WE SO AFRAID OF GROWTH?

CONVENTIONAL WISDOM DOESN'T HOLD ANYMORE

Can't we do better than this?

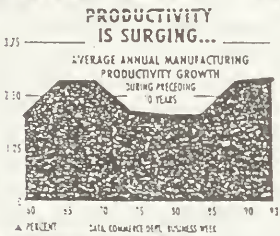
Ever since the U.S. economy powered ahead at a torrid pace late last year, the financial markets have feared that accelerating growth would send prices spiraling. To beat inflation to the punch by cooling off the economy, the Federal Reserve Board has already raised short-term rates in three quarter-point installments since early February. And Wall Street expects more rate hikes to come, even though the economy expanded at only a 2.6% clip in this year's first quarter.

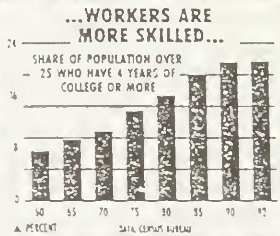
It's beginning to look as though any surge in growth will be squashed in the interests of keeping the inflation nemesis under control. Most forecasters assume that economywide productivity growth will average some 1% a year. And to that labor force growth of 1.5% or less, and the long-term growth potential of the economy comes to between 2.0% and 2.5% a year. Any pace faster than that, and the economy rushes headlong into production bottlenecks that ignite a wage-and-price spiral.

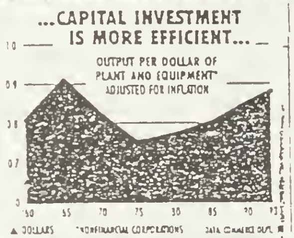
Certainly, the Clinton Administration "is comfortable with 2.5% as our long-run forecast," says Laura D'Andrea Tyson, chair of the President's Council of Economic Advisers. And Robert T. Parry, president of the Federal Reserve Bank of San Francisco, recently told a gathering of forecasters that "for the last two years, the rate of growth has been faster than the economy can sustain in the long run." No wonder every bit of good economic news gives the financial markets the jitters—sending bond and stock prices tumbling.

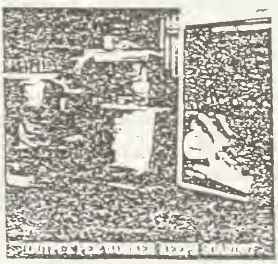
But the fears of the forecasters and the markets may be unfounded. "People

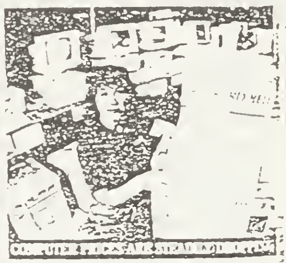
WHY STRONG ECONOMIC GROWTH WON'T CAUSE FASTER INFLATION











are taking the last 15 years and just projecting them forward," says Richard Nelson, economist at Columbia University. The conventional outlook underestimates Corporate America's huge productivity gains, a historic wave of technological innovation, and the spread of capitalism around the world. "Productivity has dramatically improved compared with the prior two decades," says Bruce Steinberg, economist at Merrill Lynch & Co. "And improved productivity means the economy can grow more rapidly without triggering inflation."

STILL STINGY. True, the recent pickup in manufacturing activity is raising the specter of production bottlenecks. Yet in an increasingly global economy, many American companies can shift excess order flows to factories overseas. And with nearly one-fifth of all goods bought in the U. S. produced overseas, foreign competitors are eager to expand their sales should stateside companies aggressively raise prices. White-hot international competition puts a damper on the ability of U. S. companies to jack up prices.

Fed Chairman Alan Greenspan agrees that the growth prospects of the U. S. economy have improved. He believes the economy's underlying growth trend of productivity in both manufacturing and services has recently risen to 1.5% and that the noninflationary growth potential of the U. S. is certainly higher than the modest pace projected by conventional wisdom. "U. S. businesses in recent years have been investing in new capital and improving their use of capital in ways that are making the U. S. economy more productive," Greenspan recently wrote.

Still, the Fed isn't joining in any victory dance—at least not yet. Instead, it has been pursuing a tightfisted monetary policy as part of a campaign to convince the markets that it won't let inflation erupt.

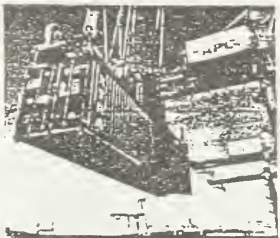
And the markets, it seems, need a lot of convincing. They were seared by megabuck losses during the 1970s price spiral and won't risk trillions more until they have positive proof that higher productivity growth rates are here to stay and inflation will remain dormant. For example, consumer price increases are running at a 2.6% annual rate and investors are demanding a yield of more than 7% on 10-year Treasury bonds. By contrast, when inflation was this low back in the mid-1960s, investors only required a yield of 5%.

FAR FROM BEING A MATURE ECONOMY, THE U.S. IS ONE IN THE THROES OF A HISTORIC TRANSFORMATION

How good can growth get before the economy overheats? Perhaps a lot better than most people think. Over the past three years, productivity has been rising far faster than the rate assumed by the typical forecast—a 2.6% average annual rate, similar to the experience of the 1950s and 1960s.

In part, this reflects the typical productivity rebound that follows a recession. But with business equipment investment hitting 9% of gross domestic product, its highest level in the postwar period, the productivity surge is likely to continue. Tack on labor-force growth, and that means the economy's noninflationary growth potential could be as high as 3.5%—and not for two quarters

The U.S. economy has expanded at a 2.4% annual rate since 1980. Most forecasters figure that the economy's growth potential is 2.5% at best. But the evidence is mounting that it could be as high as 3.5% without touching off inflation. Here's why:

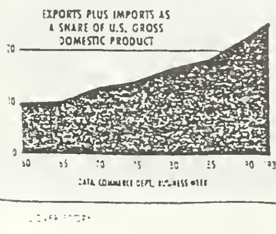


PRODUCTION CAN BE MOVED OFFSHORE

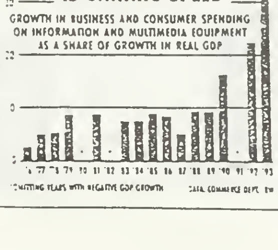
THE U.S. HOLDS THE DIGITAL EDGE

CONSUMERS ARE SITTING PRETTY

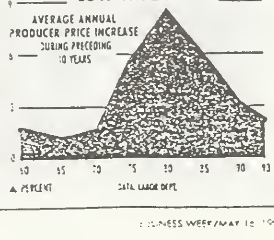
...INTERNATIONAL TRADE IS EXPANDING...



...AND THE INFO REVOLUTION IS GAINING SPEED



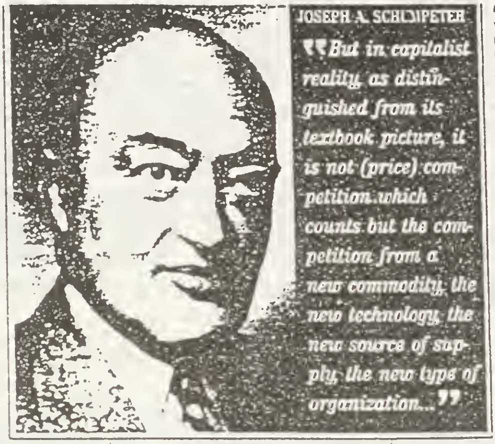
THE RESULT: LOW INFLATION



Cover Story

or a year, but perhaps for the rest of the decade.

The gap between a growth rate of 3.5% and 2.5% may not seem like much, but it's the difference between eating fish eggs and caviar. The higher growth rate would cumulatively add about $1.2 trillion more, in 1987 dollars, to the nation's output by the year 2000. It would increase total business investment over the next six years by $170 billion. Per-capita income would rise to $23,600 instead of $22,250. The federal budget deficit would shrivel, and the U.S. could afford to spend plenty more on education, training, and scientific research, the seed-corn of future growth. Strong growth creates a powerful, self-reinforcing dynamic all its own.



STUNNING PACE. Of course, many economists remain convinced that America can't grow faster because it's a mature economy. The U.S., they say, has lost its economic and technological leadership in field after field to Asian and European rivals. To survive, companies are slashing costs by eliminating workers even entering the fourth year of recovery. The cold war's end, with the resultant cutbacks in the defense industry, is dampening growth, too. "Everyone hopes the rate of technical progress can pick up and the rate of productivity growth will pick up," says Gary Burtless, economist at the Brookings Institution. "But there is little basis for optimism."

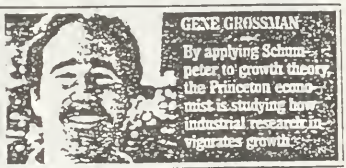
But is the U.S. really stuck in mediocrity? "Economies have a way of defying expectations," says Alan Brinkley, a professor of history at Columbia University. For example, economists expected anemic growth in the U.S. in the wake of World War II. But for the following generation the economy grew at a stunning pace. How about the limits-to-growth panic of the 1970s? Oil, food, and other commodities once feared in short supply are now in cheap abundance. Says Robert Eisner, economist at Northwestern University: "Economists look at what has been happening and say that must be natural. Growth has been slow so it must stay slow."

What the slow-growth forecasters fail to appreciate is that the U.S. is in the throes of a transformation. Underlying the recent acceleration in productivity is a gathering web of technological and commercial innovations revolutionizing the economy, much as steam power did in the late 1700s and electricity did in the late 1800s.

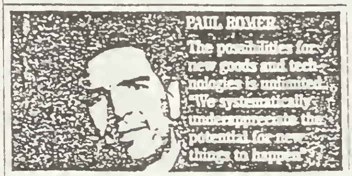
The Industrial Era is giving way to the Information Age. "We are living

ECONOMISTS FOR AN EXPANDING UNIVERSE

These days, a growing school of economists are asking what propels growth and drawing inspiration from the ideas of Joseph A. Schumpeter (1883-1950), the Austrian economist and Harvard University professor. Like Schumpeter, these economists are focusing on technology, innovation, and knowledge. And the underlying message of the Schumpeterians is fundamentally optimistic. "The one fact that comes from economic history is the ability of the human mind to break through barriers that weren't imaginable 50 years ago," says Joel Mokyr, economic historian at Northwestern University.



Traditionally, mainstream economics has been unable to explain what determines long-term growth. In the late 1950s, Nobel laureate Robert M. Solow of Massachusetts Institute of Technology showed that increases in the economy's labor supply and capital stock explained only part of growth. The rest was attributed to technological change. But it was largely unexplainable.



The Schumpeterians go beyond traditional economics to look at what really drives technological change. They are analyzing how growth is affected by the support for technical innovation, educational institutions, and rewards to entrepreneurs for coming up with new products. A leading Schumpeterian is Paul Romer of the University of California at Berkeley, perhaps one of the country's most influential young economist. Romer's theoretical work breaks new ground by showing how technological progress can supercharge growth, just as a new jet turbine or a new biotechnology drug spells the difference between a plodding economy and a dynamic one. Romer and other new growth theorists are finding support from such

through one of these fundamental and profound changes in the economic paradigm built around the transmission, retrieval, and analysis of data and falling transport and communication costs," says Richard Lipsey, an economist and fellow at the Canadian Institute for Advanced Research.

And the Information Revolution is only part of a much bigger innovation wave. U. S. patent applications have surged by a remarkable 35% over the past six years. The financial services industry keeps churning out new products tailored to meet the needs of a global economy. Pioneers in biotechnology and multimedia are building whole new industries. Old-line companies like General Electric, AT&T, and Alcoa are shedding bureaucracies and rigid hierarchies to foster responsiveness and creativity. "Innovation is the mother of all core processes, encompassing all levels and functions of a corporation," says Richard Foster, director at McKinsey & Co. "And U. S. companies are collectively the most innovative in the world."

GROWTH GURU. Conventional economics falls short in dealing with the impact of such momentous upheavals. The kind of models that predict a 2.5% limit to noninflationary growth describe a world where the economy plods ahead at a rate determined by the amount of capital and labor employed, while fiscal and monetary policies are geared toward keeping the economy's fluctuations within a fairly narrow band. Of course, conventional models do an excellent job of describing how interest rates affect home buying or how higher taxes crimp consumer spending. But they are almost mute when it comes to measuring how new technologies affect growth.

To better grasp the relationship between innovation and growth calls for turning to an economic tradition championed by the late Joseph Schumpeter, one of the 20th century's intellectual giants. Schumpeter developed the idea of creative destruction, the process by which new technologies, new markets, and new organizations supplant the old. "Except for Karl Marx, Schumpeter was the only economist who placed strong emphasis on innovation and technological change as sources of economic growth," says Frederic M. Scherer, economist at Harvard University.

In recent years, Schumpeter has become a leading light to a group of economists struggling to answer the most basic question in economics: What drives growth? Like Schumpeter before them, these economists argue that innovation is the essence of capitalism. Knowledge and its application to real business problems count for more than capital and labor, the traditional factors of production. Entrepreneurs, industrial research, and knowledge are what matters (box).

DISINFLATION IS FAST BECOMING THE NORM IN THE ONCE INFLATION-PRONE AMERICAN ECONOMY

The U. S. is not an aging, mature economy to the Schumpeterians, but rather it can generate almost unlimited possibilities of new goods and new technologies. "Knowledge doesn't face diminishing returns. It's an expanding universe," says Richard Baldwin, economist at the Graduate Institute of International Studies in Geneva. Adds Paul Romer, economist at the University of California, Berkeley: "We systematically underappreciate the potential for new things to happen."

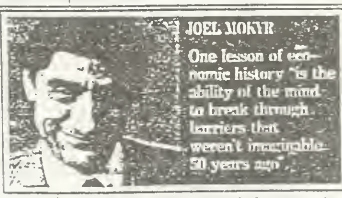
It's easy to lose sight of the importance of innovation on growth because it doesn't have a straight-line impact. Picture this: a chart with an S-shaped curve. When a new technology is introduced into a company, productivity actually falls as workers and managers struggle to master different techniques and skills. But as more and more people move up the learning curve, the new technology begins to pay dividends, and productivity surges ahead. And sometimes innovations come in clusters, such as now with computers, communications, and other high-tech information systems. When that happens, the S-curve effect is magnified as each advancing technology feeds off the other.

History offers striking examples of the S-curve effect. Take electricity. Many of the critical advances came in the 1870s and 1880s. But it wasn't until

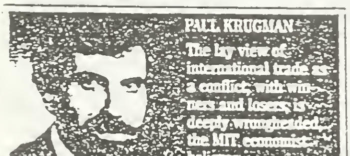
economic historians as Paul David of Stanford University. His empirical studies show the historic interplay between technological change and economic growth.

The most recent wave of research from the Schumpeterians focuses on the links between international trade and growth. In traditional economic theory, the benefits from free trade to a large economy such as the U. S. come mainly because consumers and businesses can pay lower prices for imports. While this is no small potatoes, it doesn't do much to increase growth in the long run.

Yet free trade may have a much bigger payoff than conventional economics allows. Free trade encourages the rapid spread of technology and industrial ideas, according to such trade theorists as Gene M. Grossman of Princeton, and Elhanen Helpman of Tel-Aviv University, who have been influenced by the pioneering work of Paul R. Krugman of MIT. Trade can also invigorate growth by providing access to bigger markets. Conversely, in many cases, barriers to trade slow the rate of technological transmission, leaving a protectionist country lagging far behind.


JOEL MOKYR
One lesson of economic history "is the ability of the mind to break through barriers that weren't imaginable 50 years ago"

Take the developing countries of Latin America and the former East bloc nations. They learned the hard way that erecting trade barriers to protect domestic industries isolated them from global technological progress and helped condemn them to years of stagnation. And without fierce competitive pressure from the Japanese auto companies, it's doubtful U. S. carmakers would have felt compelled to engineer productivity gains of 10% a year in the 1980s.


PAUL KRUGMAN
The lay view of international trade as a conflict, with winners and losers, is deeply wrongheaded, the MIT economist believes.

Beyond trade, the theory has far-ranging implications for economic policy. Governments, business, and universities have a key part to play in affecting the pace of innovation. Some Schumpeterians would like to see stronger government support of commercial technology, especially in the service sector, and others more industry collaboration to develop world-class products. "To achieve long-run success, economic policy must support the institutions that generate ideas and technological progress," says Romer.

By Christopher Farrell in New York

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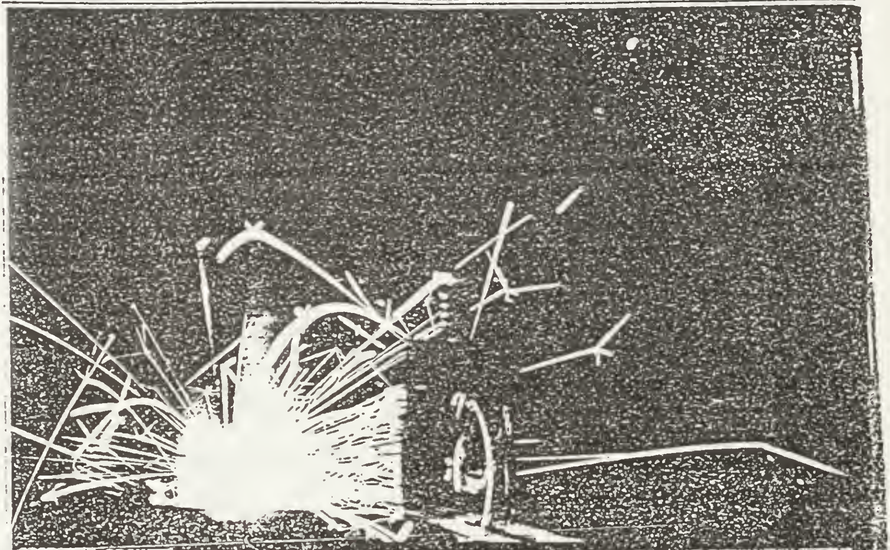


SPARKING GROWTH INNOVATIONS TODAY ARE COMING IN CLUSTERS—COMPUTERS, COMMUNICATIONS, AND INFORMATION SYSTEMS

two to three decades later that the productivity-enhancing promise of electrification was realized. Overall, U.S. productivity jumped to a 2.4% annual rate in the early 1900s vs. a 1.3% pace in the late 1800s, according to Paul David, economic historian at Stanford University.

EVOLUTIONARY CLIMB. Similarly, after a long lag, information technologies are just now living up to their economic promise. Says W. Daniel Hillis, cofounder of Thinking Machines Corp., a Cambridge (Mass.) maker of massively parallel-processing supercomputers: "Society has to adapt around new technologies. That takes longer than developing the technologies themselves. The good news for the economy is we have a lot [illegible] in the pipeline that will start paying off."

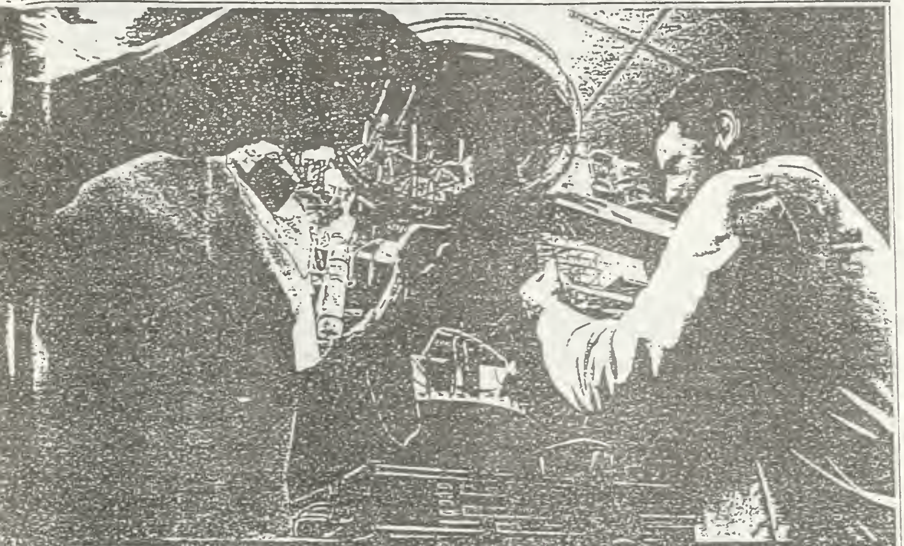
It's about time. For the past decade or more, the gale winds of "destruction" have been all too painful and [illegible]. Battered by vicious competition at home and abroad, companies have substituted information technologies for labor, eliminating millions of jobs. Corporate layoff announcements in the first quarter were up 11% from the same period last year, according to Challenger, Gray & Christmas Inc., an international outplacement firm. Delta Air Lines Inc. has just announced plans to eliminate 15,000 jobs in a mammoth restructuring, and overall unemployment levels are disturbingly high. The lethal combination of technological change and increased competition has slashed the real wages of low-skill and less educated workers, too.

Now, the signs of the payoff are finally here: Companies are becoming much more efficient. Anheuser-Busch Cos., the world's largest brewer, is replacing packaging equipment installed some 15 to 20 years ago with newer technology that requires fewer workers. Without adding any more workers, Mead Data Central, a leading electronic supplier of databases, is providing access to a lot more data. "We added 300 billion characters in 1993, and we'll probably add 250 billion characters this year," says Rodney L. Everhart, president of Mead Data.

Indeed, the rate of return on telecommunications investment is around 30%, including indirect benefits to the economy, says Francis Crofts, managing director at Bell McGraw [illegible]. And a recent study by Frank R. Lichtenberg, economist at Columbia University School of Business, found that one [illegible] systems worker can replace six other employees without affecting output.

Savvy companies are also discovering that breaking down the century-old command-and-control bureaucracies has an impact on innovation. For example, Toledo-based Dana Corp., a $5.5 billion producer of automotive and other industrial products, actively solicits ideas from employees at its 197 manufacturing plants scattered all over the world. "The power of that is incredible," says Southwood J. "Woody" Morcott, Dana's chief executive.

"QUITE ISOLATIONIST." Stitching together teams from engineering, design, finance, marketing, and production also seems to be boosting research and development productivity. As Rockwell International Corp. has shifted more of its R&D from long lead-time defense work to the fast-paced commercial market, it is tying its scientists to teams within the organization, according to Robert L. Cattoi, senior vice-president at Rockwell. Says John Seely Brown, head of the Xerox Corp.'s Palo Alto Research Center, better known as PARC: "We've moved from being quite isolationist to having a rich set of conversations with all parts of the company. Yet now we're probably bringing out



BIO-BEHEMOTH NEARLY NONEXISTENT TWO DECADES AGO, THE BIOTECH INDUSTRY NOW BOASTS ALMOST 700 ACTIVE COMPANIES

more fundamental things than we ever have."

The benefits of the productivity boom are just beginning to boost worker incomes. Wages and salaries, after adjusting for inflation, are rising smartly for the first time in seven years. And a new study by North Carolina State economist Steven G. Allen shows that skilled workers in high-tech companies make more than their counterparts in less innovative outfits. "In industries with lots of R&D activity, you see a much more rapid growth in wages of college graduates [illegible]

The official statistics [illegible] productivity [illegible] inflation [illegible] measure of output per unit of work [illegible] easy to calculate in the manufacturing industries [illegible] when it comes [illegible] information technologies, [illegible] account for more than [illegible] economy, the productivity measures are inadequate, says Zvi Griliches, economist at Harvard University. For example, more and more supermarkets have installed bar code readers in their checkout lines, making them faster and more accurate. Yet these gains to consumers do not show up in the government's numbers. With prices falling so fast in the high-tech market and quality improving so rapidly, the beancounters make mush of the productivity numbers.

> IN THE HIGH-TECH MARKET, FALLING PRICES AND SOARING QUALITY ARE MAKING MUSH OF THE PRODUCTIVITY NUMBERS

What is clear, however, is that since it takes less money to buy better products, the productivity of capital is enhanced. For instance, computer users are accustomed to increasing their processing power by a factor of [illegible] every [illegible] seven years at no additional cost. Overall, prices of computers and telecommunications equipment have plunged [illegible] over the past [illegible] years. The government's statisticians say that technological improvements and quality adjustments suggest that the consumer price index is overstated by some 0.5 percentage point—which would put it at a 2.1% annual rate instead of the posted 2.6%.

The forces holding inflation in check are also powerful. Labor costs are well under control and wage pressures almost completely absent. Unions have been sidelined, too. The number of workers covered by cost-of-living adjustments in major collective bargaining agreements is now lower than at any time in the past quarter century—from a high of 61% in 1976 to a low of 24% in 1993. The three-week strike by 75,000 Teamsters barely disrupted the economy in April. By contrast, when the Teamsters last struck, in 1979, the 10-day work stoppage caused widespread production [illegible]

GLASS CUSHIONS. The old rules of thumb about capacity utilization constraints and inflation flashpoints may no longer work, either. A lot of U.S. companies have plenty of manufacturing capacity to spare. When order flows surge [illegible] increase, companies can shift [illegible] to plants in Mexico, Canada, Asia, and other regions. Take Owens-Illinois Inc., the Toledo-based [illegible] glass containers. Owens is running [illegible] glass plants at capacity, and

Cover Story

The company is bringing in product from operations in Venezuela and elsewhere. Strong capital goods spending is quickly adding to the capital stock and raising capacity levels. Companies are increasingly adroit at boosting productivity and raising capacity, too. "It seems we get more creative each month," says Donald P. Hilty, chief economist at Chrysler Corp.

Even in those parts of the economy where prices are up, they aren't spiraling. Look at steel. Steel service centers, which purchase and distribute nearly 45% of all U.S.-made stainless steel, are shipping record volumes, and raw-steel producer plants are running near capacity. Over the past year, prices of flat-rolled steel have gone up from $310 a ton to $355, and scrap metal prices from an average of $97 to $147 per ton. But prices are leveling off with excess supply available from overseas makers. The price of scrap, used in minimills, has started to decline. When U.S. scrap prices surged, European buyers turned to cheaper Russian pig iron. "I don't think prices are going to go a lot higher," says F. Kenneth Iverson, chairman and CEO of Nucor Corp.

Disinflation is fast becoming the norm in the once inflation-prone U.S. economy. Producer prices are rising at only a 0.2% annual rate, and even medical-care inflation has dropped from an annual rate of more than 9% in 1990 to less than 5% currently. Economists often underestimate how long price trends can last, too. Over long stretches in history, inflation has been well-behaved. For instance, between 1860 and 1940, the annual rate of increase in the consumer price index was [illegible], and it was 2.5% between 1940 and 1970, says Stephen S. Roach, economist at Morgan Stanley & Co. "With intense competitive pressures offering industry little alternative, there is good reason to believe that the fundamental break between the cost curve of the 1980s and those of the past will persist."

Higher U.S. productivity and technological innovation is a big competitive advantage in overseas markets too. Sure, the U.S still runs a merchandise trade deficit of some $130 billion a year, and worries about international competitiveness run deep. Japan and Europe are devoting huge private and public resources to nurturing science and technology. And the fast-growing economies of East Asia and Latin America are encouraging foreign multinational investment as a way of transferring manufacturing and management knowhow.

ALTERED POSITIONS. Nonetheless, U.S. companies are globally competitive in many leading-edge industries. The biotechnology industry, for example, was nearly nonexistent two decades ago and now has almost 700 active companies. The foundations of the Information Superhighway are being laid, despite the breakup of the mega-merger between Tele-Communications and Bell Atlantic. China's Guangdong province may be growing at 15% a year, but the Internet is expanding by 15% a month. Competitive high-tech goods are a key reason why U.S. export growth has averaged more than 9% a year over the past seven years—more than three times the gains of Japan and Germany. "And as consumers tap into the Information Highway, the competitive position of nations and industries may be further altered," says Steinberg of Merrill Lynch.

> AMERICA IS THE ONLY INDUSTRIALIZED COUNTRY TO HAVE DEREGULATED AIRLINES, TELECOM, AND TRUCKING

Indeed, in the U.S. there are fewer impediments to "creative destruction" than elsewhere. Regulatory burdens are fewer and market competition more intense. America is the only industrial country to have deregulated its airlines, financial services, telecommunications, trucking, and other industries. For instance, largely reflecting the competitive forces unleashed by deregulation, a blended measure of labor and capital productivity shows the U.S. telecommunications industry is as much as twice as productive as its counterparts in the major European countries, according to an analysis by McKinsey & Co. "What's important is that competition energizes new ways of doing things," says Donald McCloskey, economist at the University of Iowa.

Labor is highly flexible, too. And the nation's borders are more open. Research, development, and technological innovation are skills that are forged in the crucible of international competition. Most important, though, is America's entrepreneurial tradition. From Andrew Carnegie to Bill Gates, the incandescent lightbulb to spreadsheets, the U.S. has long been open to the ideas of innovators, mavericks, and immigrants. And these entrepreneurs have generated tremendous bursts of growth in the past. "What is our comparative advantage?" asks Zoltan Acs, economist at the University of Baltimore. "It is our ability to innovate."

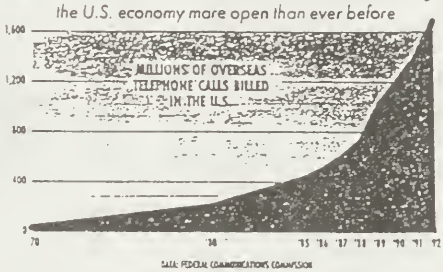
Clearly, the U.S. economy is emerging stronger than it has been after two decades of turmoil. The nation is more productive and more competitive than at any point since the early 1960s. The biggest threat to the wellsprings of faster growth comes from the troubling combination of zealous restraint by policymakers and the inflation jitters of bond market investors. Both threaten to squander the economy's potential strength and all the jobs and wealth it would produce.

The U.S. can do better—but not if it continues to fear growth.

By Christopher Farrell, with Michael Mandel in New York, and bureau reports

GLOBAL COMMUNICATIONS ARE ON A ROLL

Traffic in information across borders has soared, making the U.S. economy more open than ever before



DATA: FEDERAL COMMUNICATIONS COMMISSION

Fed Goes Ghostbusting

By Lester C. Thurow

CAMBRIDGE, Mass. The Federal Reserve Board has been spooked by the ghost of inflation. In its panic, the Fed has raised interest rates three times, taking everyone by surprise. Long-term bondholders have lost billions and international currency markets have been rattled. Yet the Fed's economists admit they can't point to even a hint of inflation in the current numbers. They are missing the obvious: the 90's are likely to be an inflation-free decade, and their interest rate hikes will squash the current economic recovery.

The 70's and 80's were inflationary times. The failure to raise taxes to pay for the Vietnam War led to slowly accelerating inflation that exploded with the oil and food shocks of the 70's. Inflation stubbornly receded in the 80's. If the effects of surging health care costs are subtracted from inflation figures, it is clear that more prices have fallen than risen this spring.

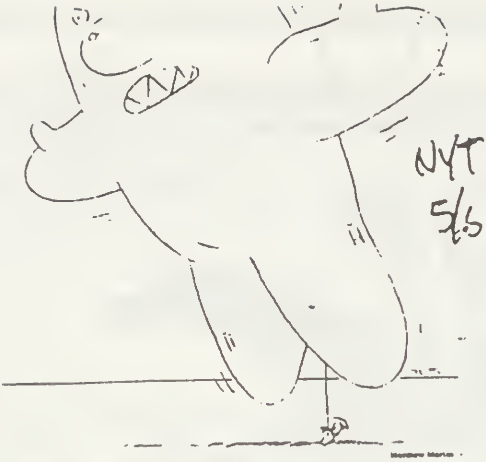
Sophisticated investors including George Soros, Citicorp and Bankers Trust took huge losses because of the Fed's action. They were betting on low interest rates because they had no worries about inflation. The Fed's economists contend that it takes 12 to 18 months for higher interest rates to stop inflation, so they are acting now to prevent renewed inflation in 1995. In the Fed's view, the economy is so prone to inflation that even this slow recovery from the 1991-1992 recession — 3 percent growth in 1993 and 2.6 percent in the first quarter of this year — represents an overheated economy.

The 90's began with a deflationary crash in asset values: property prices in the United States declined by up to 50 percent. This trend spread to England, flattened Japan and is now rocking Germany. While the U.S. stock market has risen (the money flowing into pension and mutual funds has had nowhere else to go), the inflation-adjusted fall in the Japanese stock market in the 90's has been bigger than the decline in the American stock market from 1929 through 1932. Worldwide, hundreds of billions of dollars in wealth have been wiped out.

One traditional cause of inflation is a shortage of labor, which drives up wages. Yet global unemployment rates are reaching levels not seen since the Depression. Spain reports 24 percent and Ireland and Finland not much less. In the U.S., if one adds together the officially unemployed, discouraged workers who have stopped actively searching for work and those with part-time jobs who want full-time work, 15 percent of the labor force (19 million) is looking for work.

The Fed is worried that an increasing number of U.S. companies are running close to their production limits — that they will be unable to keep up with the demand for goods, thus

Lester C. Thurow is professor of management and economics at the Massachusetts Institute of Technology.



driving up prices. But in today's global economy, what counts is world capacity, not U.S. capacity. No American will have to wait for a new car: since auto makers in Japan and Europe aren't producing at anywhere near capacity, U.S. producers aren't going to raise prices and sit by and watch their market share erode. While America's economic recovery is under way, the rest of the industrial world shows no sign of coming back; until it does, inflation will not quicken.

The demise of the Soviet Union and the effective collapse of the Organization of Petroleum Exporting Countries in the aftermath of the Persian Gulf War means there will be no repetition of the energy or food shocks of the 70's. What has been happening in aluminum will be repeated in most raw materials: 1.3 million metric tons were exported from the former Soviet Union in 1993, causing the lowest real (adjusted for inflation) prices in history.

Oil prices are lower in real terms than before the first OPEC oil shock in the early 70's, yet exports from the former Soviet Union have barely begun and Iraq has yet to be brought back into world oil markets. When Ukraine comes back into production (it was the world's largest exporter of grain in the 19th century), food prices will plunge.

The decline in real wages that began in the U.S. and is spreading across the industrial world further undermines the Fed's contentions. Among American men, salaries are falling at every education level — for those in the bottom 60 percent income bracket, real wages are 20 percent below 1973 levels. Women with a high school education or less have seen their wages drop, and it looks like the same will happen to college educated women soon. At the same time, productivity is increasing at the highest rates seen since the 60's. Wages down, productivity up — that simply isn't the recipe for inflation.

Raising interest rates is killing the recovery.

Economists differ on the causes of falling wages. Immigration and technical innovation are partly responsible, but some worldwide trends are also behind it. The Communist bloc did not run very good economies but it ran excellent education systems. One-third of humanity, much of it skilled, is joining the capitalist world. If some of the world's best physicists can be hired in Russia for $100 per month, why should anyone pay a third-rate American physicist $50,000 a year?

In the 80's, only 60 million people in Singapore, South Korea, Hong Kong and Taiwan were export-oriented. With the decline of state socialism in East Asia, hundreds of millions of third-worlders (two billion Indians and Chinese) are going to be joining them. Inflation is going to be impossible in any country with open borders: lower-priced goods will flood in from low-wage countries.

In addition, the layoffs at big U.S. companies with high wages and good benefits are unrelenting. More than 109,000 jobs were cut in January, a record. Getting rehired after being laid off usually means a cut in pay, and the competition for these lower-paying jobs drives overall wages — thus inflation — further down.

Since World War II, American companies have typically held prices constant, or even raised them, while distributing the fruits of productivity in the form of higher wages or profits. But under the pressure of international competition, that system is rapidly eroding. In the 90's productivity gains will lead to lower prices, not wage increases.

Large manufacturers are forging new arrangements with their suppliers. For example, Chrysler used to have hundreds of suppliers, but it has given a few of them exclusive rights to supply all of its parts, and Chrysler engineers will give them design information. In exchange, the suppliers will lower their prices every year. In such scenarios, the manufacturers will in turn pass their savings on to customers in the form of lower prices.

At least one member of the Federal Reserve Board has extolled the virtues of zero or negative inflation. This ignores a tenet of capitalism: it doesn't work very well when prices are falling. When prices fall (and many prices must fall to have zero inflation, since some prices will always be rising), the smartest move is to postpone purchases. With prices lower tomorrow, only a fool buys today. So investment falls as people forgo entrepreneurship to become inactive rentiers. Money in the mattress becomes the only smart investment. Deflationary times are tough times.

Yet the Fed is intent on killing a very weak recovery that has yet to include most Americans. The 7 percent growth rate in the fourth quarter of 1993 was heavily concentrated in housing, automobiles and business equipment. High interest rates will hurt these sectors, and the Fed's large rate increases have hit the economy at a time when growth has already slowed dramatically.

Since January, interest rates on 30-year Treasury bonds have risen 1.3 percent and those on 30-year fixed rate mortgages have risen 1.5 percent. These rates did not soar because of worries about inflation. Rather, they reflect the payoff that investors must demand to protect themselves from a Fed that thinks inflation is about to rise from the grave. The Fed's erratic behavior has also led to a currency crisis that made necessary Wednesday's billion-dollar effort to protect the dollar. While nobody has ever been hurt by ghosts, investors are showing that they have real reason to fear a ghost-busting Fed.

WP 5/6/94

GAO to Push for Derivatives Regulations

Report Will Recommend SEC Set Standards, Monitor Activities

By Brett D. Fromson
Washington Post Staff Writer

NEW YORK, May 5—The General Accounting Office will recommend that Congress give securities regulators more control over volatile and complex financial instruments known as derivatives, and limit derivatives trading by federally insured banks for their own accounts, according to sources who have been briefed on a forthcoming GAO report.

The GAO draft report calls for the Securities and Exchange Commission to supervise the derivatives activities of registered broker dealers, who now place most of this business in unregulated affiliates beyond the reach of the SEC.

The GAO's draft recommends that the SEC set standards for how companies manage the risks associated with derivatives.

It said corporate boards of directors should be required to monitor and approve their companies' activities in derivatives.

It also called for better reporting and accounting of derivatives by companies.

The report is likely to be a political and analytical touchstone in the coming battle on Capitol Hill about how best to protect the financial system from possible dangers posed by derivatives.

These instruments derive their value from price movements in underlying markets such as stocks, bonds, currencies and commodities.

Wall Street sells them to speculators looking for highly-leveraged bets and to companies looking to hedge business risks.

The report comes on the heels of recent derivative-related losses by major U.S. corporations, banks, brokerages and investment firms. The losses have called into question industry claims that derivatives are simply "risk management tools."

Banks and investment houses earn fees for designing and selling derivatives, and use derivatives extensively in their proprietary trading.

Officials of some dealer firms say regulation will hurt their profits.

The report does not call for dramatically expanded supervision of derivative activities at commercial banks.

The report does, however, reiterate recent statements by Comptroller of the Currency Eugene Ludwig that questioned why banks should be allowed to trade for their own accounts—a risky business—using federally insured deposits.

In a separate development, Standard & Poor's Corp. announced today it had lowered the rating on Bankers Trust New York Corp. to AA-minus from AA.

Bankers Trust recently announced that it lost $49 million trading for its own account in the first quarter.

"S&P believes the increased involvement in proprietary trading . . . introduces an element of volatility that is not consistent" with the higher rating, Standard & Poor's said.

ISBN 0-16-044602-3
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